

香港特別行政區政府
The Government of the Hong Kong Special Administrative Region

房屋及規劃地政局
香港花園道美利大廈



Housing, Planning and Lands
Bureau

Murray Building, Garden Road,
Hong Kong

- 本局檔號 Our Ref. (34) in HD/PS 9/2/1
來函檔號 Your Ref.

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11 December 2003

Clerk to LegCo Panel on Housing
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong
(Attn: Miss Odelia Leung)

Dear Odelia,

Legislative Council Panel on Housing


**Arbitration between Housing Authority and Zen Pacific
relating to Yuen Chau Kok Short-Piling Case**

Thank you for your letter of 5 December 2003 requesting disclosure of the confidential paper on the "arbitration between Housing Authority and Zen Pacific relating to Yuen Chau Kok Short-Piling Case" and the letter of the Secretary for Housing, Planning and Lands dated 12 November 2003 to the Honourable Audrey Eu, SC, JP.

We have relayed legislators' concerns to Zen Pacific, which has agreed to the disclosure of information relating to the Yuen Chau Kok case. With this consent, we have no objection to the de-classification of the information paper and the letters of the Secretary for Housing, Planning and Lands to the Honourable Audrey Eu, SC, JP, copies of which are enclosed.

Please let me know if you require further assistance.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Joey Lam', written in a cursive style.

(Miss Joey LAM)
for Secretary for Housing, Planning and Lands

c.c. AA/SHPL
DD/CS
DD/BD

Legislative Council Panel on Housing

Arbitration between Housing Authority and Zen Pacific relating to Yuen Chau Kok Short-Piling Case

Purpose

This paper briefs Members on the arbitration on the contract dispute between the Housing Authority (HA) and its piling contractor, Zen Pacific, in relation to the Yuen Chau Kok short-piling case. Both the arbitration and the subsequent settlement agreement between HA and Zen Pacific are subject to usual non-disclosure conditions. In order to enable Members to gain a better understanding of the matter, we have secured Zen Pacific's consent to our disclosure to Members of the Legislative Council, of pertinent information about the arbitration and the settlement agreement.

Background

2. In 2000, after discovering defective piling works for two building blocks at Yuen Chau Kok, HA¹ decided to demolish the two blocks and subsequently took various actions against the piling contractor, Zen Pacific. These actions include –

- (a) removing Zen Pacific permanently from HA's Lists of Large Diameter Bored Piling Contractors and Demolition Contractors;
- (b) prohibiting Ngo Kee (a sister company of Zen Pacific with broadly the same management) from tendering for all HA projects for a period of 24 months; and
- (c) seeking, through arbitration, to establish Zen Pacific's liability for breaches of contract and hence compensation from it for HA's losses arising therefrom.

¹ Most matters concerning the piling works and the contract dispute between HA and Zen Pacific are handled by the Building Committee of HA under delegated authority.

3. The contract between HA and Zen Pacific provides generally that a contract dispute between the contracting parties must be settled by mediation or arbitration. Having considered various possible alternatives (see paragraphs 7 - 10 below for additional information) to recover HA's losses, HA decided in early 2001 to go for arbitration in accordance with contract provisions.

4. In the arbitration, HA sought to establish that Zen Pacific had breached the contract in failing, inter alia, to construct the piles in accordance with specifications, to properly supervise the works, and to discover and report the defects. Furthermore, HA sought damages in the amount of \$605 million, comprising HA's direct costs of \$212 million (including wasted expenditure, demolition costs, investigation costs and abortive costs), compensation claimed by the superstructure contractor of the two demolished blocks (up to \$65 million), as well as loss of asset value (\$328 million). On the other hand, Zen Pacific lodged counter-claims against HA for damages incurred as a result of alleged negligence by HA and its agents in carrying out inspections of the piling works.

Outcome of Arbitration

5. The arbitration was completed in August 2003 after an eight-week hearing. The arbitrator determined that there was a series of breaches of contract by Zen Pacific including those mentioned in paragraph 4 above, and dismissed its counter-claims against HA in their entirety. The arbitrator awarded to HA \$199 million for its direct costs, full indemnity by Zen Pacific for any HA payment to the superstructure contractor, plus interests and legal costs². No award was made for loss of asset value mainly because of HA's decision not to rebuild the two demolished blocks.

² The cumulative legal cost incurred by HA is \$38.6 million over a period of 4 years (2000 - 2003). This cost comprises \$20.8 million for solicitors' fees, \$8.0 million for counsels' fees, \$6.8 million for experts' fees, \$2.4 million for arbitrator's fees, and \$0.6 million for other arbitration expenses. The cost reflects the protracted process and complexity of the case.

Settlement Agreement

6. After the arbitrator's award was made, HA entered into negotiations with Zen Pacific, at the latter's request, for a settlement of the award. An agreement was subsequently reached. Under this agreement, Zen Pacific will pay HA \$80 million in phases before the end of 2004 as full and final settlement of the arbitrator's award. Zen Pacific's parent company, Wai Kee Group (a listed company in the Stock Exchange of Hong Kong), will guarantee to pay HA any shortfall in the event that Zen Pacific defaults in paying the settlement sum in whole or in part. HA has decided to accept this settlement having regard to the financial position of Zen Pacific. The settlement sum of \$80 million already exceeds the net asset value of Zen Pacific as assessed by a professional accounting firm commissioned by HA. The payment will be made in phases to allow Zen Pacific, with net asset value well below \$80 million, to ease its cash-flow difficulties. This settlement arrangement represents the best that HA could get from Zen Pacific in the circumstances.

Previous Offers of Settlement by Zen Pacific

7. There is concern that the amount ultimately recovered from Zen Pacific through the arbitration is less than the settlement offers previously proposed by Zen Pacific. Members may wish to note the following sequence of events leading to the arbitration and the factors that HA took into account in deciding to resolve the contract dispute through arbitration.

8. In June 2000, Zen Pacific made two alternative offers to HA as follows -

- (a) Zen Pacific to pay HA \$100 million by instalments, with Wai Kee Group providing a parent company guarantee for the payments; or

- (b) Zen Pacific's sister company (Ngo Kee) to build two replacement blocks at a price of \$465 million payable by HA, and Zen Pacific to compensate HA for abortive piling and building costs and the superstructure contractor's claims.

The following main conditions were attached to these offers -

- (a) Zen Pacific will voluntarily de-list from HA's List of Large Diameter Bored Piling Contractors, and will refrain from bidding for any other HA contracts for one year;
- (b) HA will use its best endeavours to persuade Government to maintain business relationship with Zen Pacific for all types of contracts except large diameter bored piling;
- (c) HA will use its best endeavours to encourage the two railway corporations and the Airport Authority to trade normally with Zen Pacific;
- (d) HA will not make any further sanction against any company of the Wai Kee Group, or any company having directors in common with the Group arising from the defective piling case; and
- (e) HA will not sanction any officer of Zen Pacific arising from the defective piling case except in circumstances of suspected criminal conduct.

9. These offers were rejected by HA in July 2000. After consideration, HA made the following counter-proposal to Zen Pacific -

- (a) HA to receive a sum of \$200 million by instalments; and
- (b) Zen Pacific to be de-listed from HA's Lists of Large Diameter Bored Piling Contractors and Demolition Contractors.

Zen Pacific responded with an offer of \$140 million by instalments but resisted being de-listed from demolition works. HA rejected Zen Pacific's revised offer. In view of public discontent about sub-standard piling works in public housing projects at the time, HA was keen to make public the whole matter to achieve transparency and to establish the liability of the contractor. On these considerations, HA preferred litigation in court (which was not the normal route of dispute resolution as provided under the contract) to a negotiated settlement.

10. Subsequently, in January 2001, having regard to the fact that the Independent Commission Against Corruption had charged a number of persons involved in the case for criminal offence, as well as the establishment by the Legislative Council of a Select Committee to examine various incidents related to construction problems in public housing, HA considered that the facts of the case would be made public in due course. As the objective of exposing the matter to the public would be met, HA decided to go for arbitration with Zen Pacific in accordance with contract provisions, instead of litigation as originally intended.

11. The arbitration process started in mid-2001. In November 2002, Zen Pacific proposed two alternative offers for settlement -

- (a) a cash payment of \$50m plus \$10m for legal costs; or
- (b) a cash payment equivalent to two-thirds of its net asset value (\$80 million as claimed by Zen Pacific).

Noting that HA had a strong case to win in the arbitration, and that the cash offer was much lower than the previous offer of \$140 million made in July 2000, HA rejected the offers.

12. It should be noted that the primary reason for HA to pursue litigation or arbitration, instead of a negotiated settlement, is to establish and demonstrate to the community that the liability falls fully and squarely on Zen Pacific. HA's rejections of Zen Pacific's offers were consistent with this over-riding consideration. HA was well aware of the consequence that, in taking the course as it did, it might ultimately

recover much less than it would have got had it accepted a settlement, having regard to the probable decrease in net asset value of Zen Pacific over time and the legal costs involved.

Housing, Planning and Lands Bureau
November 2003

**余若薇立法會議員辦事處**

CB(1)584/03-04(03)

Office of Audrey Eu, Legislative Council Member

To be personally delivered by Audrey Eu

16th October 2003

Mr. Michael Suen, GBS, JP
Chairman
Hong Kong Housing Authority
The Government of HKSAR
Hong Kong

Mr. Chairman,

I have received a complaint about the recent arbitration settlement with Zen Pacific.
It is alleged that:

1. The Housing Authority failed to disclose that the \$80M will only be paid over 2 years and not in one lump sum.
2. The settlement of \$80M is small viewed against the claim of \$650M. The claim was exaggerated in order to shift all the blame away from the Housing Authority to Zen Pacific.
3. At an early stage, Zen Pacific offered \$180M payable by instalment every 6 months but this offer was not taken up.
4. There was conflict of interest in that the Housing Authority appointed Messrs. Simmons & Simmons, in which Philip Nunn, a member and later Chairman of the Building Committee was senior partner, as its solicitors for the arbitration.
5. Soon after the commencement of the arbitration Zen Pacific made a sealed offer of \$80M but this was not accepted and the cost for arbitration increased.
6. The Housing Authority's legal cost came to \$40M, thus the Housing Authority only received \$40M from the settlement.

I would be grateful to have your comments on the above.

Yours sincerely,

Audrey Eu



CB(1)584/03-04(04)

 香港房屋委員會
Hong Kong Housing Authority

孫明揚
The Honourable Chairman
MICHAEL M Y SUEN
Hong Kong Housing Authority

12 November 2003

Hon Audrey Eu
Room 429
Central Government Offices
West Wing
11 Ice House Street
Hong Kong

Dear Ms Eu,

Thank you for your letter of 16 October referring to a complaint which you have received about the Housing Authority (HA)'s arbitration settlement with Zen Pacific Civil Contractors Ltd. (Zen Pacific).

In view of the wide-ranging implications of the matters mentioned in your letter, I ordered a thorough examination into them.

A detailed response to the points raised is set out at the Annex to this letter. Since the Housing Panel of the Legislative Council has also asked to be briefed on this issue, a paper setting out the background and the results of our examination will be issued to Members.

I have taken into account the need for transparency which might be compromised by the non-disclosure conditions in the arbitration and the settlement agreement between the Housing Authority and Zen Pacific. I have, therefore, secured Zen Pacific's consent to our disclosure, on a confidential basis, to you and other Members of the Legislative Council, of pertinent information about the arbitration and the settlement agreement.

Should you require further clarification, please do not hesitate to let me know.

Yours sincerely,

(Michael M Y SUEN)
Chairman
Housing Authority

b.c.c. PSH

**Detailed Response to
Points Raised in Hon. Audrey Eu's Letter**

Point 1

The Housing Authority failed to disclose that the \$80m will only be paid over 2 years and not in one lump sum.

On the insistence of Zen Pacific, the settlement agreement contains a non-disclosure provision to the effect that nothing in the agreement may be disclosed to any third party without the written consent of parties to the agreement. We have previously obtained the agreement of Zen Pacific to disclose the settlement sum of \$80m to the public, but not the terms related to when and how this sum will be paid to HA. We have now obtained the further agreement of Zen Pacific to disclose all pertinent information about the arbitration and the settlement agreement to Members of the Legislative Council on a confidential basis.

According to the settlement agreement, Zen Pacific will pay HA \$80m on or before 31 December 2004. A part payment in the amount of \$10m will be paid by 31 December 2003 and a further part payment of \$20m by 15 September 2004. Wai Kee Holdings Ltd., the parent company of Zen Pacific, has guaranteed to pay any shortfall to HA in the event that Zen Pacific defaults in paying HA the settlement amount in whole or in part. In agreeing to these payment terms, we have taken account of the fact that the net asset value of Zen Pacific is well below \$80m and Zen Pacific may have cash flow difficulties to pay the entire sum upfront.

Point 2

The settlement of \$80m is small viewed against the claim of \$650m. The claim was exaggerated in order to shift all the blame away from the Housing Authority to Zen Pacific.

The claim was \$605m, comprising the following items –

- a. costs incurred by HA (wasted expenditure, demolition costs, investigation costs, abortive costs) - \$212m;
- b. compensation claimed by Paul Y-ITC General Contractors Limited (Paul Y) (superstructure contractor of the two demolished blocks with

- piling problems) - \$65m; and
- c. loss of value of asset - \$328m

The arbitrator determined that there was a series of breaches of contract by Zen Pacific, and dismissed all its counter-claims against HA. The arbitrator awarded HA \$199m for *item a*, full indemnity by Zen Pacific to HA for any payment to Paul Y under *item b*, plus interests and legal costs. No award was made for *item c*. HA was fully aware that the case to claim for loss of value of asset was not as strong as that for *items a* and *b* because of HA's decision not to rebuild the two demolished blocks.

The settlement sum of \$80m represents the best that HA could get from Zen Pacific given its financial position. The amount exceeds the net asset value of Zen Pacific as assessed by a professional accounting firm commissioned by HA in September 2003, and we have secured a guarantee from Zen Pacific's parent company to honour the settlement agreement.

Point 3

At an early stage, Zen Pacific offered \$180m payable by instalment every 6 months but this offer was not taken up.

Zen Pacific made two offers to HA in June 2000 –

- a. Zen Pacific to pay HA \$100m (\$20m upfront and \$10m for 8 years thereafter). The Wai Kee Group to provide a parent company guarantee for these payments; or
- b. Zen Pacific's sister company (Ngo Kee) to build two replacement blocks at a price of \$465m payable by HA, and Zen Pacific to compensate HA for abortive piling costs (\$28m), building costs paid to Paul Y (\$119m) and Paul Y's claims (\$30m-\$66m).

The following main conditions were attached to these offers –

- a. Zen Pacific will voluntarily de-list from HA's list of large diameter bored piling (LDBP) contractors, and will refrain from bidding for any other HA contracts for one year;

- b. HA will use its best endeavours to persuade Government to maintain business relationship with Zen Pacific for all types of contract except LDBP;
- c. HA will use its best endeavours to encourage KCRC, MTRC and Airport Authority to trade normally with Zen Pacific;
- d. HA will not make any further sanction against any company of the Wai Kee Group, or any company having directors in common with the Group arising from the defective piling case; and
- e. HA will not sanction any officer of Zen Pacific arising from the defective piling case except in circumstances of suspected criminal conduct.

The above two offers were rejected by the HA's Building Committee (BC) at its meeting on 3 July 2000. BC felt that the second offer was too complex and that it would not be appropriate to appoint Ngo Kee to rebuild the two blocks without going through proper tender procedure.

After further discussion, BC agreed to make the following counter-proposal to Zen Pacific –

- HA to receive a sum of \$200m (an upfront payment of \$100m. The remaining \$100m to be paid by 5 equal annual instalments); and
- Zen Pacific to be de-listed from HA's lists of LDBP and demolition contractors.

Zen Pacific responded with an offer of \$140m (an upfront payment of \$40m and the remaining \$100m to be paid by 5 equal annual instalments). It resisted the extension of de-listing to demolition works. BC unanimously rejected Zen Pacific's revised offer. The BC meeting was held at a time when there was very strong public discontent about the piling scandals and the blame was put on HA. The Legislative Council had just passed a resolution of no-confidence on the then Chairman of HA and Director of Housing. Against this background, BC was keen to make public the whole matter to achieve transparency and to establish liability of the contractor; hence was apprehensive about a negotiated settlement.

Point 4

There was conflict of interest in that the Housing Authority appointed Messrs. Simmons & Simmons, in which Philip Nunn, a member and later Chairman of the Building Committee was senior partner, as its solicitors for the arbitration.

In January 2000, in view of the fact that urgent legal advice was required on HA's legal position in relation to the piling defect cases in order to advise the BC, and in consideration of the need for independent advice, we decided to conduct a tendering exercise to appoint solicitor firms with established practice in the area of building law to advise on seven defective piling projects. After consulting the Department of Justice and the then Works Bureau, we compiled a list of 10 firms, which constituted Hong Kong's major construction dispute practice and invited eight of them to submit proposals. The other two were not invited because they were known to be representing contractors concerned.

The initial brief to these firms was to conduct a preliminary assessment of the strengths and weaknesses of the cases assigned to them and to estimate the cost and time involved. Six submitted proposals. Two declined because they were also representing contractors. We selected four from the six having regard to the firms' experience, personnel and fees. Simmons and Simmons was one of the four firms (third in overall score) and was assigned to deal with the Zen Pacific case. The two firms with higher scores were each assigned to deal with more than one project.

In the event, BC, having considered the legal advice given, decided to take actions against the piling contractors concerned and these four solicitor firms were appointed to continue with their actions in relation to those piling contractors in the projects they had already advised on.

Philip Nunn is a senior partner of Simmons & Simmons recognized for his expertise in handling construction dispute cases and in resolving such disputes by arbitration. He was nominated by Simmons and Simmons to be in charged of the case and the legal team on the basis of his expertise.

Philip Nunn declared his interest every time before BC discussed matters related to the Zen Pacific case, and attended BC meetings in his capacity as HA's legal adviser for the case. Whenever the case was discussed, he vacated from the Chair and another member was elected to stand in as acting Chairman. BC was fully aware that he was serving in his capacity as HA's legal adviser during the discussion of the case.

In considering reports, proposals and recommendations in relating to the Zen Pacific case, HD and or members always took into account the relevant facts and the merits of the case and made the appropriate decision in the interests of HA. There is no question that there was any conflict of interest in the appointment of Simmons & Simmons.

Point 5

Soon after the commencement of the arbitration Zen Pacific made a sealed offer of \$80m but this was not accepted and the cost for arbitration increased.

Zen Pacific proposed two alternative offers on 15 November 2002 –

- a. A cash payment of \$50m plus \$10m for legal costs; or
- b. A cash payment equivalent to two-thirds of its net asset value.

BC considered the two offers at its meeting on 21 November 2002 and found them unacceptable. BC noted that HA had a strong case to win the arbitration, and that the cash offer was much lower than the previous offer (\$140m) made in July 2000.

The arbitration process started in mid 2001, which was more than one year before Zen Pacific made these offers. Had a settlement been reached in November 2002, it is correct that the cost for arbitration would be less than the actual cost incurred, as it would no longer be necessary to continue the arbitration. However, from the outset, the primary reason for BC to pursue arbitration instead of a negotiated settlement is to establish and demonstrate to the community that the liability falls fully and squarely on Zen Pacific. BC's rejection of the offers was consistent with this overriding consideration.

Point 6

The Housing Authority's legal cost came to \$40m, thus the Housing Authority only received \$40m from the settlement.

The cumulative legal cost incurred by HA is \$38.6m¹ over a period of 4 years (2000 - 2003). HA will receive \$80m from Zen Pacific as settlement for the arbitration award. The legal cost incurred by HA will not be deducted from the sum due from Zen Pacific under the settlement.

BC was fully aware that HA might not be able to recover much from Zen Pacific at the end of the arbitration. During the course of the arbitration, BC was advised on many occasions that given the financial position of Zen Pacific, the amount to be recovered eventually would be insignificant after deducting the arbitration-related costs. For example, at the meeting in January 2001 when BC decided to proceed with arbitration, it was pointed out in the relevant BC paper that *HA had a strong case to establish Zen Pacific's liability, and that there should be a very significant award of quantum in HA's favor. However, any recovery would be limited to Zen Pacific's assets in 2 to 3 years time when the arbitration was concluded. There was no parent company guarantee offered to HA by Zen Pacific. At best HA would recover its legal costs and a small percentage of the amount awarded.* A similar message was repeated at BC meetings in June and August 2001 when the progress of arbitration was discussed.

¹ Position as of 28 October 2003. The costs include \$20.8m for solicitors' fees, \$8.0m for counsels' fees, \$6.8m for experts' fees, \$2.4m for arbitrator's fees, and \$0.6m for other arbitration expenses.



To be personally delivered by Audrey Eu

18th November 2003

Mr. Michael Suen, GBS, JP
Chairman
Hong Kong Housing Authority
The Government of HKSAR
Hong Kong

Dear Mr. Suen,

Thank you for your letter of 12th November 2003 which is marked private and confidential. I confess I have difficulty with your refusal to make this letter public. It concerns matters of public interest and in which the public has a right to know. At the very least, I have to account to the person who lodged the complaint with me in the first place.

I have some initial queries with your detailed response.

On point 1, you refer to the payment of \$80 million. However you only refer to the payment of \$10 million on 31st December 2004 and the further part payment of \$20 million by 5th September. There is no reference to the balance of \$50 million.

On point 3, you say that the BC was keen to make public the whole matter to achieve transparency and to establish liability of the contractor, hence it was apprehensive about a negotiated settlement. I assume the anxiety for transparency holds true throughout. Hence I find it all the more difficult to understand your request for confidentiality.

On point 4, I do not challenge the integrity of Mr. Nunns and his firm. However is there any guideline as to the desirable practice in cases of this type? Mr. Nunns and his firm are no doubt very experienced in this type of case, but in advising whether to carry on or to settle the litigation, there is a direct conflict between him/his firm and the Housing Authority (especially if the other side is not going to be good for the entire claim and legal costs). How can this conflict of interest be avoided?

On point 5, you reiterate the point that higher offers in the past were rejected because of the overriding consideration to demonstrate that the liability fell fully and squarely on Zen Pacific. How is your current stance of reaching a confidential settlement with Zen Pacific consistent with that overriding consideration?



余若薇立法會議員辦事處

Office of Audrey Eu, Legislative Council Member

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On point 6, you have said that the cost of \$38.6m will not be deducted from the sum due from Zen Pacific under the settlement. How then is the cost paid, when and by whom?

Overall I am concerned with your concluding remarks that "BC was fully aware that HA might not be able to recover much from Zen Pacific at the end of the arbitration". Given that to be the case, was it justifiable to spend all that time and legal cost in taking the matter so far? Does the Housing Authority owe the public an explanation on this point? How can this be resolved if the matter has to be discussed under "private and confidential" cover? Surely the government knew that it would be wrong to reach such terms with Zen Pacific?

I have copied our correspondence to the Chairman of the Housing Panel for their further handling.

Yours sincerely,

Audrey Eu

cc. Hon. Albert Ho
Chairman of the Panel on Housing



CB(1)584/03-04(06)

 香港房屋委員會
Hong Kong Housing Authority

孫明揚
The Honourable
MICHAEL M Y SUEN
Chairman
Housing Authority

4 December 2003

Hon. Audrey Eu
Room 429
Central Government Offices
West Wing
11 Ice House Street
Hong Kong
(Fax: 2899 2249)

Dear Ms Eu,

Thank you for your letter of 18 November requesting clarification of some points in the detailed response attached to my 12 November letter to you in connection with the Zen Pacific case. I am pleased to enclose at Annex I a detailed response to your questions.

As regards your concern about my previous letter being graded confidential, you will no doubt realize that the Housing Authority (HA) is bound by the usual non-disclosure conditions of arbitration proceedings, as well as by confidentiality provisions in the subsequent settlement agreement between Zen Pacific and HA. Indeed, from its standpoint, HA welcomes full disclosure of the arbitration award and the terms of the settlement agreement. However, Zen Pacific has hitherto insisted that all information must be kept confidential save that contained in the joint public announcement (reproduced at Annex II) after conclusion of the settlement agreement.

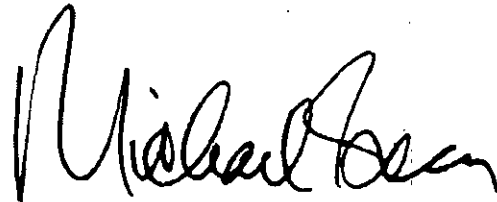
In view of your letter of 16 October and the request of LegCo Housing Panel for information about the case, we persuaded Zen Pacific to consent to our disclosure, on a confidential basis, to you and other Members of the Legislative Council, of pertinent information about the matter. An information paper was issued under confidential cover to the LegCo Panel on Housing on 13 November.

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We recognize that you have to account to the person who lodged the complaint with you, and have since persuaded Zen Pacific to further agree that the information in my two letters may be disclosed to the complainant. Zen Pacific has also agreed that, if deemed essential by the LegCo Housing Panel, all relevant information may be made public and de-classified. In this connection, I note that the LegCo Panel on Housing has requested for the relevant information to be made public at its meeting on 1 December 2003. We will respond favourably to any request from the Panel in this regard.

I hope the above addresses your concerns. Should you require further clarification, please let me know.

Yours sincerely,



(Michael M. Y. Suen)
Chairman
Housing Authority

c.c. Hon. Albert HO
Chairman, LegCo Panel on Housing

b.c.c. PSB
DD(CS)

Annex I***Point 1***

Under the agreement, Zen Pacific will pay the Housing Authority (HA) \$80 million *on or before 31 December 2004*. A part payment of \$10 million will be made by 31 December 2003, and a further part payment of \$20 million by 15 September 2004. The balance will be paid on or before the end of 2004.

Point 3

As explained in the main body of the letter, the demand for confidentiality came from Zen Pacific. HA cannot disclose any information concerning the arbitration award or the settlement agreement without the consent of Zen Pacific. We have now obtained the agreement of Zen Pacific that, if deemed essential by the LegCo Housing Panel, all relevant information may be made public.

Point 4

There are provisions in HA's Standing Orders (SOs) governing declaration of interests by its members, as well as employment of members in a professional capacity. Mr. Philip Nunn has complied with all the relevant SOs.

You have suggested that Mr Nunn and his firm may have direct conflict of interest when advising HA whether to carry on or to settle litigation. Indeed, such potential conflict of interest exists for any legal firm advising its client in a similar situation. Whether Mr. Nunn is a HA member or not is not really relevant. Mr. Nunn always declared his interests in accordance with the relevant SO before attending Building Committee (BC) meetings to discuss matters related to the Zen Pacific case. The meeting was fully aware that when Mr Nunn spoke on the subject, he was acting in his capacity as HA's legal adviser for the case and not as a member of HA and therefore did not participate in the decision-making process. At least at one BC meeting, Mr Nunn advised the meeting that 'the likely outcome would be that although the Authority would be awarded a substantial sum in arbitration, it might be an empty judgement in view of (Zen Pacific)'s asset position.'

- 2 -

Point 5

HA reached a settlement agreement with Zen Pacific only after the arbitration award had been made. The arbitrator determined that Zen Pacific had failed to construct the piles in accordance with specifications, to properly supervise the works, and to discover and report the defects. The arbitrator also rejected all counter-claims by Zen Pacific against HA. On this basis, the arbitrator awarded compensation to HA in the amount of \$199 million, among others.

The arbitration award has demonstrated that the liability for the short-piling falls fully and squarely on Zen Pacific. On this basis, and at the request of Zen Pacific, we entered into negotiations with Zen Pacific for a settlement. Taking into account a professional accountant firm's assessment that Zen Pacific's net asset value at that time was much less than the money owed to HA, and that if Zen Pacific was liquidated HA was unlikely to recover any money because HA was an unsecured creditor, HA decided to accept Zen Pacific's offer of \$80 million for settlement. This sum already exceeded the net asset value of Zen Pacific. We also obtained a guarantee from Zen Pacific's parent company (a listed company on the Stock Exchange of Hong Kong) to pay any shortfall to HA in the event that Zen Pacific defaults in paying HA the settlement amount in whole or in part. The settlement was reached in the best interest of HA and the public in the circumstances.

On the insistence of Zen Pacific, the settlement agreement was kept confidential. However, we persuaded Zen Pacific to agree to make a public announcement (copy at Annex II) on the settlement amount and the fact that a substantial award of damages had been made in favour of HA.

Point 6

The total legal cost of \$38.6 million is paid by HA from its own coffers to various parties over the four-year period from 2000-2003.

Overall comment

We have explained in detail, in the LegCo Housing Panel paper at Annex III, the considerations underlying BC's decision to pursue the course of action as it did in the Zen Pacific case. All the decisions were made under due process and after careful deliberations, and had the full backing of BC members. We consider that the decisions made are sound and in the best interest of HA and the public.

Annex II

HA's statement on a settlement agreement concerning a piling project in Shatin

The following is issued on behalf of the Housing Authority:

Subsequent to the detection of defective piling works in Blocks D and E of Shatin Area 14B Phase 2 in early 2000, the Housing Authority (HA) engaged in an arbitration with Zen Pacific Civil Contractors Ltd (ZPCCL), the piling contractor of the project. The following is a statement jointly issued by HA and ZPCCL today (25 September 2003) in relation to the settlement of the arbitration.

The Hong Kong Housing Authority (the Authority) and Zen Pacific Civil Contractors Limited (Zen Pacific) have now concluded arbitration proceedings arising out of the defective piling for Blocks D and E of Contract 166 of 1997 relating to Shatin Area 14B Phase 2 (the Project).

A substantial award of damages has been made in favour of the Authority by the Arbitrator. Zen Pacific has entered into an agreement with the Authority which results in a sum of HK\$80 million being paid to the Authority. This is in excess of the net asset worth of Zen Pacific. Any sums relating to the Project recovered by Zen Pacific from any sub-contractor or consultant will also be paid to the Authority.

The Authority and Zen Pacific confirm that all outstanding issues between them in relation to the Project have now been resolved.

END/NNNNN

25 September 2003 (Thursday)