

December 11, 1998

Sir Donald Tsang
Financial Secretary
The Government of Hong Kong
Special Administrative Region
12/F., Central Government Offices
West Wing
Lower Albert Road
Hong Kong

Dear Sir Donald

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Cyber-Port
PCG's Submission of 9 December

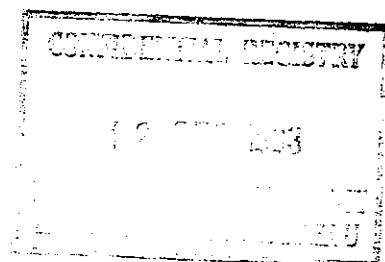
You asked for PCG's rationale as to why a Private Treaty Grant would be warranted for this project. Attached please find PCG's considered views on this matter. Mr. Richard Li has asked me to forward these views to you in his absence overseas. Of course, we would be prepared to elaborate if required.

Yours sincerely,

Alex Arena

Alex Arena
Chief Executive Officer
Pacific Convergence Corporation

c.c. Mr. K.C. Kwong
Mr. Gordon Siu



CYBER-PORT
The Pacific Century Group's (PCG) Submission to the Financial Secretary
of 9 December 1998

Issue : Whether PCG's proposal of 9 December warrants a Private Treaty Grant (PTG).

Background : PCG has provided an alternative proposal for the Government's consideration whereby PCG would be prepared to design, develop, project-manage and construct the Cyber-Port; participate in its management; and arrange for private sector funding for the entire project. Details of PCG's proposal are encapsulated in its submission dated 9 December 1998.

A central tenet of PCG's proposal is that private sector funding, to be harnessed for this project, requires some form of financial precedent. PCG has structured its proposal based on well established financial precedents e.g. those pertaining to MTRC residential and commercial developments over its railway stations.

To activate PCG's scheme 50 year Rights-to-Use over the Cyber-Port site must be granted to a Cyber-Port Management Company and PCG. On this basis PCG could undertake to fund and develop the Cyber-Port which would be passed over to the Cyber-Port Management Corporation.

This approach has the hall-marks of a Private Treaty Grant (PTG) and the issue arises whether the Pacific Century Group ought to be granted such a PTG without an open tender process.

Consideration: PCG is strongly of the view that an open tender process is **not** warranted with respect to a PTG for the Cyber-Port. PCG's views are based on the following grounds:

- 1) The risks to the Government in using an open tender approach;
- 2) Timing issues

Tendering Risks. The risks to Government of an open tender are manifold. PCG has been able to develop and articulate the Cyber-Port concept because it is in the Information Services business and has an intimate knowledge of this business. To be effective, the Cyber-Port must be a finely-tuned facility and it is unlikely that any traditional property development company in Hong Kong would have the requisite understanding of the needs of the Cyber-Port to be able to make a sensible or credible tender application for delivery of the Cyber-Port. The situation is analogous to a Disneyland theme-park; only Disney can deliver the concept -- hence a Disneyland cannot be subject to tender. PCG is uniquely placed in that it is the only property development company in Hong Kong with a track record in technology and information services.

Should the Government attempt to pursue open tender, PCG would have grave reservations about the Government's ability to establish appropriate selection criteria for tendering. Nor would PCG be convinced that any selection criteria would be able to adequately protect the Government from a bid that seemingly complied yet failed to deliver. The Government has just one opportunity to get the Cyber-Port right – a protracted tender process that yielded a second-rate outcome would actually cause great harm to Hong Kong's aspirations in IT and Information Services; the potential sacrifice of a valuable piece of land; and the loss of its economic value to Hong Kong's economy.

It is well known that tendering exercises often result in surprises or unwelcome outcomes. Hong Kong is not immune from such experiences and examples readily come to mind. As other Governments have found out (e.g. India with respect to opening its telecoms market and the US with respect to spectrum auctions) it is extremely difficult and debilitating to recover from these experiences. The tender process while giving the appearance of openness and fair opportunity can be subject to 'game-behaviour' whereby bids can be structured to succeed not for the expected purposes but for other reasons such as to thwart a potential competitor, frustrate new entry or create confusion and litigation and thereby preserve the status quo for a while longer.

Hence the first risk to Government in open tendering is the possibility of a wrong selection of winning tenderer or a flawed process which fails to deliver the project. The second risk is that the selected tenderer may bring the wrong tenants to the Cyber-Port.

PCG has maintained consistently that the selection criteria for tenants for the Cyber-Port must be stringent. The Cyber-Port must be additive to Hong Kong's existing stock of Multi-National Corporations (MNCs), brand-name companies in IT and Information Services, and Small and Medium Enterprises (SME's). There is a real danger that the winning tenderer in an open tender process could seek to profiteer by offering brand-name companies yet fail to deliver additive value. This could happen, for instance, if the winning tenderer simply convinced existing companies in Hong Kong to transfer from their existing office locations into the Cyber-Port. PCG contends that the Cyber-Port vision was never meant to offer alternative accommodation for MNCs' normal office needs – rather, the Cyber-Port is intended to bring to Hong Kong new, leading-edge, Information Services units of MNCs and brand-name companies to Hong Kong so as to improve Hong Kong's position as a contender for the Region's premier position in IT and Information Services.

PCG would doubt the Government's ability, even with the best of intentions, to guard against the possibility that other property developers could easily circumvent the 'spirit' of developing the Cyber-Port while remaining within the 'letter' of the definition of "Cyber-Companies" (since it is difficult to be precise by the use of words such as "high-tech", "high-value added", "advanced" etc in a field that changes as rapidly as the Information Services sector). Other property developers could seek to maneuver within these definitions either deliberately (in an attempt to increase their margins) or simply due to ignorance or a genuine lack of understanding of the intricacies of this sector.

However, in either case, public policy would suffer if all an open tender process yielded was a botched implementation of the Cyber-Port vision.

Again using the theme-park analogy, PCG would expect that if Hong Kong was to pursue a theme-park it would strive to obtain the best. It should not settle for 'Six Flags', which until April 1998 was 49% owned by Time Warner and, which runs a distant third in theme parks when it could have Disney or Universal Studios. No-one could deny Time-Warner as a brand-name but in theme-park it simply does not rate strongly enough hence its sale of 'Six Flags' to Premier Parks in April 1998. An open tender for a theme park could yield 'Six Flags' as the winning bidder – an outcome hardly likely to be welcomed as the right outcome given the opportunity cost of losing Disney. An open tender for the Cyber-Port risks the same sub-optimal outcome.

Timing issues. PCG's concerns on timing are also substantial. By virtue of the Chief Executive's Policy Addresses in 1997 and 1998, Hong Kong has spelled out its ambitions in IT and IT-related sectors. Hong Kong is attempting to move rapidly now – but the reality is that it has much lost ground to recover. Hong Kong's Regional competitors (in particular, Japan, Singapore, Australia, India, Taiwan and Malaysia) are taking active steps to encourage investment (local and inbound) in these new sectors of economic activity. Hong Kong needs to announce a definitive plan of action that substantiates the policy vision which has been articulated and to show, undeniably, that Hong Kong is in this business now.

A decision in favour of the Cyber-Port would be a strong signal in this respect. But the impact of this potentially strong signal could be negated by an announcement that the Government was moving (only) to start an open tender process. This is because it would be hard to avoid an impression that Hong Kong was still only in the planning stages and that nothing would happen for some time. It is undeniable that if the Government were to go to open tender, it would take significant procedural time to do its own research and investigations, most probably repeating the same old grounds as those already covered by PCG. Yet, because of the rush in time and the shortage of genuine experts and specialists in this new area, the exercise thus repeated may not come up with much additional value. In the meantime, for lack of certainty, such as a tendering exercise will imply those companies and experts we wish to attract will choose to go elsewhere such as Singapore which has been moving at high speed even within the past few months.

For MNCs and Information Services companies looking to establish their Asian Headquarters in the imminent future, a promise that Hong Kong would do something in a few years would not be persuasive when compared to the head-start position of its Regional competitors. It must be remembered that there is a high risk that the first Asian location that has any measure of initial success in attracting the brand-name players could build an unassailable position and go from strength to strength. Once MNCs settle in a location they do not move easily and it is easy for new comers to justify co-location with settled and established players. 1999 could be the key year in which many MNCs make their location decisions.

Another aspect of timing relates to the domestic economy. Hong Kong is facing economic hardship; hardship which the Cyber-Port could alleviate to some extent psychologically and practically. A firm decision to move ahead with actually implementing the Cyber-Port (as distinct from simply a decision to start a tendering process) would give Hong Kong people some beacon of hope for the future. Practically it would also accelerate design and physical construction work and, therefore, would create upward of 2000 jobs in an industry facing downturn in the current economic climate. An economic stimulus in 1999 could eventuate if the Government accepted PCG's proposal to implement the Cyber-Port without open tender. Conservatively, even assuming a non-controversial and uncontested outcome, an open tender could extend the project start date by a whole year.

PCG's Qualifications

PCG is uniquely placed with respect to this project. PCG's management team has leveraged its experience gained in establishing the Pan-Asian STAR television venture in the early 1990's to develop the concept of providing interactive services to the people of Asia. PCG has established the Pacific Convergence Corporation (PCC) to implement this concept. PCG has been successful in attracting considerable interest in this venture and in March 1998 chose Intel to be a 40% equity partner in this venture (more details on PCC are at Attachment 1). PC aims to be the biggest interactive services 'portal' and brand-name in Asia (and, in time, beyond Asia). It is an ambitious project that could only be undertaken by the major shareholders involved and its scale can be measured from the fact that it will employ about 1000 people at launch in 1999 and up to 5000 people after it matures.

A few key points need to be drawn out from the PCC case-study. PCG is well attuned to dealing with the biggest and the best of the IT and Information Service Companies – whether in Silicon Valley or elsewhere. Besides Intel's involvement as shareholder and hardware and software applications supplier, PCC has engaged IBM as its Systems Integrator/Prime Contractor/Potential Supplier/Potential E-commerce Partner and NCI (a division of Oracle) as its supplier of customer/server software solutions. These are substantial firms overall but the key point is that PCC is engaged with the leading edge parts of these firms in the delivery of Information Services – it is precisely these types of activities of these firms which Hong Kong lacks and, absent the right implementation of the Cyber-Port, is unlikely to ever attract to Hong Kong. First tier companies such as these see PCG as a long term strategic partner in the growth and positioning of PCC as the premier interactive service provider in Asia. Hence these companies would be highly disposed to co-locating key parts of their operations where-ever PCC establishes its headquarters.

PCC will be a massive conduit for all types of information services (educational, financial, life-style, entertainment etc). PCC will produce a great deal of its own content and will provide a delivery platform for other content creators to both bring their services to Asia or to take their services from Asia onto the world-wide Information Infrastructure. Hence PCC must work with second tier firms such as Yahoo, Lycos, Infoseek, Netscape, AOL, E-trade, Charles Schwab etc that want to develop their Chinese, and other Asian, language service offerings. These firms would be natural candidates to enter the Cyber-Port should they become business partners with PCC – however, even if they choose not to work with PCC, they would still be attracted to the Cyber-Port because of the presence of the other players.

PCG is also confident that it could attract many third tier players to the Cyber-Port. These would be software developers for both internet and non-internet applications. Many of these could be local Asian companies who might go on to become major brand-names in their own right in time. These companies would be keen to participate in the 'cluster' and 'halo' effects of a Cyber-Port that had a strong showing of first and second tier companies but they could be deterred by the costs of tenancy at the Cyber-Port. PCG has continually asserted our belief that as long as the Cyber-Port's rental costs can be kept down so that they do not exceed rentals in Silicon Valley there would be a strong chance of developing a powerful magnet for these third tier players. If Hong Kong is to develop its indigenous base of Information Services companies particular care has to be given to the strategies for bringing these third tier players into the Cyber-Port. PCG understands this – other property developers would not.

The Government needs a comprehensive strategy not an unbalanced or incomplete one. A focus on the big brand-names only; an emphasis on second tier players because they might be easier to attract; or an absence of a third tier strategy, would all be examples of how another property developer might diminish the value of the Cyber-Port. PCG is the only property developer that understands these issues; that has the project (by virtue of PCC) to implement the right balance of tenants at the Cyber-Port; and has the established connections across the three tiers of Information Services companies to be a credible contender as the Cyber-Port designer, developer, financier, project-manager and participant in the Cyber-Port management.

To summarise PCG's claims why it should be entrusted with a PTG to implement the Cyber-Port vision:

- PCG developed the vision of the Cyber-Port and has been capable of articulating that vision in conceptual design documentation
- PCG is a player in high-end commercial property development as well as being a player in technology and Information Services.
- PCG's Beijing development underscores its ability to develop and market property for the likes of MNCs such as IBM, Alcatel, Boeing and Intel.

- PCC (PCG's joint venture with Intel) is taking on the challenge to become Asia's premier Information Services provider
- PCC is willing to be a pioneer and anchor tenant of the Cyber-Port; hence PCG understands well what it will take to make the Cyber-Port attractive to Information Services companies.
- PCC will also spur the development of local Small & Medium Enterprises in this sector
- PCC is a powerful combination – it brings together Intel, with its unmatched international position and very impressive track record, with PCG's local standing and Richard Li's international standing as a Cyber-entrepreneur. Locating this project in the Cyber-Port would serve as a beacon that would immediately put Hong Kong on the map in this rapidly growing sphere of economic activity. PCG doubts that any other possible contender as developer of the Cyber-Port could bring forward a comparable, or an advanced, project as PCC.
- PCG has conducted exploratory discussions with selected MNCs and brand-names to test their interest in the Cyber-Port concept
 - based on these discussions, PCG can undertake to bring the right parts of these MNCs and brand-names to Hong Kong a claim unlikely to be matched by any other possible contender as developer of the Cyber-Port.
- PCG can deliver the project quickly and to the right quality standards because it has a professional insight to all of the essential dimensions of the project and it can co-ordinate the multi-faceted planning and project-management competently.
- PCG is prepared to shoulder substantial financial, construction and development risks to deliver the Cyber-Port yet it is prepared to do this on very thin margins.

Conclusion : PCG's principal aim is to see the Cyber-Port built for Hong Kong. Public interest demands that Cyber-Port vision ought not be compromised because a badly implemented Cyber-Port would be a backwards step for Hong Kong's fledging ambitions in this sector. An open tender process risks compromising the vision and would bring unnecessary delay to the project.

PCG would be prepared to bear considerable risks itself in delivering this project rather than see the project compromised by faulty execution by another developer. Indeed, if this latter situation were to eventuate PCG would not have any faith in good quality tenants being found for the Cyber-Port and PCC would be concerned about the risk being associated with a failing project even as a tenant. Indeed PCG would be concerned about entering into any commitments as a tenant if it appeared likely that an unsatisfactory party developed this project.

PCG has been tenacious in wanting to bring the PCC project to Hong Kong despite the fact that Hong Kong is not currently the rational or economic choice. PCG cannot maintain this position without confidence in the Cyber-Port outcome and, lacking this confidence, it must bow to market place realities.

PCG submits that its proposal has sufficient merit to dispense with the need for open tender. We would trust that the Government could agree with this conclusion so that it may move quickly to announce the project and PCG could implement it as soon as possible. To illustrate what is at stake in this new sphere of Information Services we have provided (see Attachment 2) some illustrations of the degree to which wealth has been created by key players over recent years.

THE COMPANY (PACIFIC CONVERGENCE CORPORATION)

Pacific convergence Corporation (PCC) was formed in March 1998 between Hong Kong-based Pacific Century Group (PCG) and US-based Intel Corporation (Intel) to explore commercial opportunities for providing interactive digital services in the Asia-Pacific region. PCG owns 60% of the equity and Intel 40%. PCC expects to deliver broadband data services to the Region's populations using an integrated system of advanced telecommunications networks and related technologies. The target market across Asia spans from Japan to Moscow and south to below Australia. An estimated 3.8 billion people could potentially receive PCC's proposed services. Interactive services, delivered efficiently and conveniently, would enrich the Asian public's experience in such areas as education, information, and entertainment.

PCG brings to PCC extensive experience in satellite and broadband network development and operations, and knowledge and experience in the vast Asian consumer and business market segments. PCG's management team led the successful launch of the first AsiaSat satellite and created StarTV in 1991. StarTV was the first satellite television venture to provide broad coverage of the Asia-Pacific region; in its first 36 months on the air, StarTV developed an audience of 53 million subscribers in 38 countries. PCG is particularly strong in content creation and marketing of these services in Asia.

Intel brings to PCC its expertise in the personal computer platform and silicon technology, in addition to its experience gained through a number of internal and external investments in broadband communications technologies as well as software and content creation.

PCC intends to be the leading provider of Internet-like services in Asia using both cable television infrastructure and leased digital telecommunications lines to households and businesses. PCC will offer an on-line service that will enable consumers to experience interactivity through either their television by using a set-top box or personal computers by using a cable modem. This service will enable consumers to receive interactive services over quality broadband networks at transmission speeds of up to 500 times faster than typical 28.8Kbps dial-up connection, and rich multimedia programming through an intuitive graphical user interface.

In order to expand the distribution of PCC services quickly and easily, and to shorten time to market for cable operators, the Company intends to provide turnkey solutions, to its distributors throughout the Region. These solutions will include not only a technology platform and an international brand, but also ongoing marketing, customer service, billing and product development support.

PCC intends to commence service in 1999. It has yet to decide on its Headquarters location but it will create approximately 1000 jobs at launch and up to 5000 as the business matures. PCC will invest hundreds of millions of US dollars in establishing its initial services – this investment would comprise state of the art digital content creation facilities and transmission facilities as well as powerful business systems to support complex applications like e-commerce. PCC already has powerful partners on this project. Besides Intel, IBM is contracted as PCC's Systems Integrator/Prime Contractor and NCI (a division of Oracle) is contracted to supply customer/server software for delivery of PCC's services via television sets.

ILLUSTRATIVE STATISTICS ON THE GROWTH OF KEY 1ST AND 2ND TIER IT AND
INFORMATION SERVICES COMPANIES

Market Cap. US\$ Mill

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
Intel	25,916	26,380	46,592	107,500	114,367	191,080
Microsoft	22,736	35,514	51,597	98,654	155,617	328,060
IBM	32,848	43,197	50,053	76,959	100,240	152,271
Oracle	8,178	12,636	18,364	27,381	21,821	33,956
America Online	345	862	2,817	3,080	9,067	41,233
Netscape			5,759	5,002	2,388	3,807
Lycos				145	571	2,432
Infoseek				199	293	1,261
Softbank *			5,790	4,754	2,971	5,529

(*Majority owner of Yahoo)

Market Cap Growth

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>Increase</u>
Intel	2%	77%	131%	6%	67%	637%
Microsoft	56%	45%	91%	58%	111%	1343%
IBM	32%	16%	54%	30%	52%	364%
Oracle	55%	45%	49%	-20%	56%	315%
America Online	150%	227%	9%	194%	355%	11862%
Netscape			-13%	-52%	59%	-34%
Lycos				294%	326%	1579%
Infoseek				47%	331%	533%
Softbank			-18%	-38%	86%	-5%

