

Extract from the minutes of the Finance Committee meeting on 26.11.1999

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Item No. 2 - FCR(1999-2000)48**CAPITAL INVESTMENT FUND****NEW HEAD "TOURISM"**

- ♦ **New Subhead "Equity in Hongkong International Theme Parks Limited"**
- ♦ **New Subhead "Loan to Hongkong International Theme Parks Limited"**
- ♦ **New Subhead "Subordinated Equity in Hongkong International Theme Parks Limited"**

14. On behalf of Members of the Hong Kong Confederation of Trade Unions, Mr LAU Chin-shek stated that they would only support the proposal if the Administration would pledge that workers would not be imported to fill jobs during the construction and operation stages of the Hong Kong Disneyland (HKD) project. He also urged the Administration to ensure that middle-aged, low-skilled workers would be suitably retrained to take up relevant jobs.

15. In response, the Secretary for Economic Services (SES) reiterated the Administration's stance at the recent special meetings that at present, it did not envisage the need to import labour for the HKD project. No change was contemplated for the existing control mechanism on importation of labour. He further assured members that the Administration would see to it that the retraining needs of middle-aged and low-skilled workers would be catered for.

16. Mr Martin LEE enquired whether the Disney Theme Park was capable of sustaining its attractiveness in the years to come. In response, the Commissioner for Tourism (C for Tourism) referred to Disney Theme Parks in the United States, Paris and Tokyo where there was continuous development of additional attractions to renew visitors' interest in the parks. Likewise, for the Disney Theme Park in Hong Kong, whilst only 17 attractions were planned to be provided upon park opening, over 10 more attractions would be added in subsequent years. C for Tourism also highlighted the attractiveness of a Hi-tech Hong Kong-equivalent downtown Disneyland to youngsters.

17. Mr SIN Chung-kai stated that Members of the Democratic Party (DP) supported the HKD project having regard to the following -

- (a) The financial arrangements for the project were not very satisfactory but Members of DP recognized that they were the outcome of negotiation which were mutually acceptable to the Walt Disney Company (WD) and the Government.
- (b) The HKD project would bring about economic benefits to Hong Kong and have a positive effect on the economy.
- (c) In respect of the environmental aspects of the project, about which Members of DP were gravely concerned, the Administration had

undertaken to ensure that all statutory procedures would be complied in full before commencing works. Members of DP would also urge the Government to use construction waste as fill materials as far as practicable.

- (d) The project would boost the confidence of the community, as well as the confidence of foreign investors in Hong Kong.

18. On behalf of Members of DP, he requested that the Administration should make regular reports on the HKD project to the Economic Services Panel; and that the Economic Services Panel should hold special meetings to consider these regular reports. Both SES and Mr James TIEN, Chairman of Economic Services Panel, agreed that the progress of HKD would be followed up at the Economic Services Panel and special meetings would be held where appropriate.

19. Referring to the subordinated equity of \$4 billion injected by the Government into the Hongkong International Theme Parks Limited (HKITP), Miss Emily LAU queried whether this was the best arrangement for Hong Kong, having regard to the pre-requisites before the subordinated shares in question could be converted in full to ordinary shares which attracted dividends. She was concerned that the delay in share conversion might put Hong Kong in a disadvantageous position in profit-sharing.

20. In this respect, Mr James TIEN considered that it might not be advisable to impose a moratorium of five years after park opening for conversion of subordinated shares, particularly if good profits could already be yielded in the first two or three years of operation.

21. In response, C for Tourism and the Deputy Secretary for the Treasury (2) (DS(Tsy)2) pointed out that subordinated equity was the most appropriate and fairest method mutually agreed to settle the land premium, considering that project economics in the Base Case did not permit HKITP to pay cash up front for the land. Moreover, where the company's operating performance exceeded the Base Case, this arrangement would ensure that the Government would be able to capture its fair share of the project's upside potential by way of converting the subordinated shares into ordinary shares. In the case of Tokyo, WD did not have to pay for the land for the theme park, and in France, the Government sold the land to WD at historical agricultural prices but with an approval for further development. For HKD, however, the full premium was payable.

22. Regarding the five-year moratorium after park opening for share conversion, C for Tourism said that this was necessary so as to allow sufficient time for fluctuation in business in the early years to stabilize. He further explained that under present business forecasts, HKITP would not expect to pay cash dividends until some 13 or 14 years after park opening. Hence, conversion of subordinated shares in five or 10 years' time was not so pressing an issue. DS(Tsy)2 supplemented that notwithstanding the five-year moratorium, in all upside situations, the ordinary shares converted in full at the end of the 25-year period were expected to be trading at a premium.

23. On the conversion arrangement, C for Tourism and DS(Tsy)2 advised that to make the project an attractive commercial venture to existing and potential third investors, the subordinated shares would need to be converted in a gradual manner so as not to dilute substantially within a short period of time the benefits of the ordinary shares held by other investors. C for Tourism also confirmed that where HKITP performed at or below the Base Case, no conversion would take place. He explained that in practice, the company's actual performance each year would be kept track of against the Base Case forecast. If the operating performance exceeded the Base Case, conversion of subordinated shares could commence from the sixth year onwards after park opening. Members also noted that the conversion would be effected at no extra charge.

24. In reply to Mr James TIEN's further enquiry about the reasons for imposing a permitted conversion ceiling of 5% per annum cumulatively and an annual cap of 10% on conversion, C for Tourism pointed out that while the Government would be entitled to sell down all its shares over the life of the project, WD would be required to retain at all times a minimum investment of 1.9 billion shares. WD would therefore need to safeguard against excessive dilution of its significant equity by capping the pace and rate of share conversion so that the process would take place progressively.

25. C for Tourism also pointed out that if operating performance of the HKITP far exceeded the Base Case in its initial years, the capital expenditure on expansion might also have to be brought forward. On some members' concern about capturing the fair share of the upside early, he elucidated with the scenario that if HKITP was able to pay cash dividends in its 10th or 11th year of park operation, the Government would still be able to receive dividends on some 25% to 30% of its total subordinated shares (worth at \$4 billion) converted into ordinary shares, plus dividends in respect of its equity of \$3.25 billion.

26. As regards Miss Emily LAU's question on the working mechanism of conversion, including the pace, timing and conversion caps, the Chairman suggested and C for Tourism agreed to set out the details in writing, illustrated with a chart for easy reference.

27. In this connection, S for Tsy acknowledged members' concerns about the financing arrangements for the HKD project, notably whether the subordinated equity to be injected by the Government into HKITP would be in the best interest of Hong Kong. She stressed that whilst members might be able to propose other options containing terms more favourable for Hong Kong, the present arrangement of subordinated equity was the outcome of protracted negotiation which was mutually acceptable to WD and the Government. She pointed out that as WD had been granted concessions in respect of the theme parks in Tokyo and Paris, it was quite unprepared to pay for the full cost of the land. If the Government had adopted a charging method similar to that of the French Government, the premium of the land for the Hong Kong Disney Theme Park would only amount to some \$30 million. Given that the project economics in the Base Case would not support the payment of \$4 billion in cash up front for the land, the Administration was of the view that the settlement of the premium by way of subordinated equity convertible over time in a phased manner to ordinary shares was a fair and viable option. Having

taken all relevant factors into consideration, S for Tsy re-affirmed that the present arrangement was a balanced approach in the interest of Hong Kong and all parties concerned, and which the Administration could recommend to the FC for its approval.

28. Mr HUI Cheung-ching sought the Administration's confirmation that the relevant works would not proceed before endorsement of the Environmental Impact Assessment (EIA) reports. In reply, C for Tourism re-affirmed that works for the project would not commence until all statutory procedures had been completed and relevant permits obtained in accordance with the law. In the unlikely event that the necessary Environmental Permits could not be obtained or would be subject to conditions which precluded theme park operation, then, the entire project would not proceed.

29. Noting that mainly earth or marine fill, instead of inert construction waste, would be used for stage 1 reclamation at Penny's Bay, Miss Christine LOH queried whether this choice of fill material would pose a problem if subsequent EIA studies confirmed that construction waste, instead of marine fill, should be used for the reclamation.

30. In response, the Director of Civil Engineering (DCE) clarified that the types of fill had been reviewed in the previous EIA studies conducted in respect of the container port project previously planned. He further confirmed that according to these studies, both natural fill and inert construction waste were suitable fill material for reclamation at Penny's Bay.

31. Miss Margaret NG said that having considered available information, she was not wholly convinced of the benefits brought about by the HKD project as stated by the Administration but she was prepared to let the Government go ahead. Nevertheless, she was gravely concerned that the Government seemed to have abandoned the normal procedures of satisfying the Town Planning Board of all necessary requirements, including environmental impact assessments. She queried the appropriateness of proceeding with the HKD project in the absence of information on its impact on the environment.

32. In reply, C for Tourism informed members that the Town Planning Board had agreed on a revised Outline Zoning Plan for North-East Lantau which was then gazetted in August 1999. Of the objections received so far, none challenged the planning intention of the area for tourism/recreation-related purposes. He assured members that these objections were being dealt with in accordance with the Town Planning Ordinance.

33. On the environmental aspects, C for Tourism re-affirmed previous assurances that the Administration was not relying solely on the EIA studies conducted in respect of the container port development and that a formal EIA for theme park purposes was underway. Nevertheless, he advised that based on the many studies conducted so far, there was no indication of any insurmountable environmental issues in connection with the HKD project and its associated developments.

34. In this connection, the Assistant Director of Environmental Protection (AD(EP)) advised that an EIA study by the Civil Engineering Department

(CED) had been underway for some 1½ years for the Northshore Lantau Development. Based on the current proposal, CED had also completed an Environmental Review of the reclamation works in Penny's Bay against the previously completed EIA reports. The findings of the Review were presented to the Advisory Council on the Environment (ACE) on 27 September 1999. He further pointed out that the HKD development in Penny's Bay had been gazetted as a Designated Project under the Environmental Impact Assessment Ordinance (EIAO) in July 1999 and would be subject to strict control under the EIAO and other environmental legislation.

35. On Miss Margaret NG's concern about monitoring of the progress on EIA procedures, C for Tourism said that the Administration would include information on this aspect in its periodic reports to the Economic Services Panel.

36. Miss Cyd HO referred to the recent special meeting of the Economic Services Panel where the Administration undertook to provide further information on the percentage drop in visitors to the park at which the project could still break even. However, no reply had yet been received. The Chairman recalled that at the special Panel meeting, the Administration had also pointed out that it might not be very realistic to make a projection on the basis of a change in just one variable when in fact, all variables were equally subject to changes.

37. DS(Tsy)2 advised that assuming the value of all other parameters in the Base Case scenario remained unchanged, the project could still break even if there was drop of 30% in projected attendance. Both he and C for Tourism remarked that the Administration was ready to respond to members' questions on this issue at the Public Works Subcommittee (PWSC) meeting on 17 November 1999 but no such questions had been raised.

38. In this connection, Mr James TIEN, Chairman of Economic Services Panel, pointed out that the Administration should have provided the requested information to the Economic Services Panel after the meeting as agreed, instead of leaving it to members to raise the issue at the subsequent PWSC meeting. He reminded the Administration that as a general practice, where the Administration had undertaken to provide certain information at a particular committee meeting, it should provide such information to the committee concerned, instead of relying on members to follow up on their own at another committee.

39. Miss Cyd HO asked whether the Administration would provide members with a copy of its Project Agreement with WD for the development of HKD as previously requested by some members. She considered that the Administration had not been forthcoming in releasing information on the project and in the absence of a copy of the Project Agreement, it would be difficult for members to seek information on relevant aspects of the project.

40. In response, C for Tourism re-affirmed the previous reply that due to the need to respect commercial confidentiality, the Administration would not be able to provide members with a copy of the Agreement as long as it remained commercially sensitive. Instead, the Administration had prepared, and would prepare, information papers on key aspects of the Project Agreement if so

requested by members. Miss Cyd HO said that she was not satisfied with the way the Administration disseminated information and expressed serious reservation on the present proposal.

41. The Chairman put the item to vote. 37 members voted for the proposal, 3 voted against and 1 abstained:

For:

Mr Kenneth TING Woo-shou	Mr James TIEN Pei-chun
Mr David CHU Yu-lin	Mr HO Sai-chu
Mr Edward HO Sing-tin	Mr Michael HO Mun-ka
Dr Raymond HO Chung-tai	Mr LEE Cheuk-yan
Mr Martin LEE Chu-ming	Mr LEE Kai-ming
Dr LUI Ming-wah	Mr NG Leung-sing
Mrs Selina CHOW LIANG Shuk-yee	Mr MA Fung-kwok
Mr CHEUNG Man-kwong	Mr HUI Cheung-ching
Mr CHAN Kwok-keung	Miss CHAN Yuen-han
Mr CHAN Wing-chan	Dr LEONG Che-hung
Mrs Sophie LEUNG LAU Yau-fun	Mr Gary CHENG Kai-nam
Mr SIN Chung-kai	Dr Philip WONG Yu-hong
Mr WONG Yung-kan	Mr Jasper TSANG Yok-sing
Mr Howard YOUNG	Dr YEUNG Sum
Mr YEUNG Yiu-chung	Mrs Miriam LAU Kin-yee
Mr Ambrose LAU Hon-chuen	Miss CHOY So-yuk
Mr SZETO Wah	Mr LAW Chi-kwong
Mr TAM Yiu-chung	Mr FUNG Chi-kin
Dr TANG Siu-tong	

(37 members)

Against:

Miss Cyd HO Sau-lan
Miss Christine LOH
Miss Emily LAU Wai-hing
(3 members)

Abstention:

Miss Margaret NG
(1 member)

42. The Committee approved the proposal.