

Chapter 7 Mr LEUNG Chin-man's role and participation in the Hunghom Peninsula case

7.1 This Chapter gives the background of the disposal of PSPS flats in Hunghom Peninsula and Kingsford Terrace following the cessation of the production and sale of HOS/PSPS flats in 2002. It also sets out Mr LEUNG Chin-man's role and participation in the Hunghom Peninsula case.

Disposal of outstanding Private Sector Participation Scheme flats

Private Sector Participation Scheme

7.2 The Government announced the implementation of HOS in 1976 to help eligible households and public housing tenants to purchase flats at discounted prices. It further announced the launching of PSPS in 1977 to supplement HOS under which private developers were invited to tender for housing sites on which they were required to build flats conforming to certain specifications stipulated by the Government. Unlike HOS developments which are owned by HA, PSPS developments are owned by the developers.

7.3 Similar to other Government land sale, the land title of a PSPS site is vested in the developer. The developer holds the legal title to the land lot, owns the residential units, car parking spaces and commercial facilities it builds under the same lease. The obligations of the contracting parties are stipulated in the Conditions of Sale for the housing site, under which HA is named to nominate eligible purchasers to purchase the residential units from the developer within 20 months from the date of the issue of the Consent to Sell. In the event that flats are

unsold at the end of the 20-month period, HA is obliged to purchase the flats at the guaranteed purchase price.

Moratorium on the sale of Home Ownership Scheme and Private Sector Participation Scheme flats

7.4 Since its peak in mid-1997, the property market in Hong Kong had been falling. With the global and local economies falling into recession in the years which followed, the demand for private residential flats declined. To stabilize and re-establish the confidence of the public and investors in the property market, the Government saw a pressing need to put in place a clear, comprehensive and consistent housing policy, and introduce measures concerning HOS/PSPS sale to address the imbalance between the supply and demand of private residential flats and the overlap between HOS/PSPS and private residential market.

7.5 In January 2000, HA endorsed a gradual approach to reduce its sale flat production and convert HOS/PSPS flats into PRH. On 3 September 2001, CS announced a moratorium on the sale of HOS/PSPS flats until the end of June 2002 and that the annual flat sale after the moratorium would not exceed 9 000 units up to 2005-2006.

Introduction of a re-positioned housing policy

7.6 Having regard to the imbalance between the demand and supply of private residential flats and the overlap between HOS/PSPS and the private residential market which had not improved, the Government, after conducting a comprehensive review, introduced a re-positioned housing policy in late 2002 with the objective of withdrawing from the role of property developer and minimizing its intervention in the market. On 13 November 2002, SHPL delivered a Statement at a LegCo meeting and announced the following package of nine measures:

- (a) to adjust the land supply strategy;
- (b) to co-ordinate the pace and timing of tendering of railway-related property developments, and to enable an orderly disposal of the properties;
- (c) to put in place an annually adjustable PRH programme;
- (d) to cease the production and sale of HOS flats;
- (e) to stop the mixed development projects undertaken by HKHS and HA in collaboration with private developers, and to terminate PSPS;
- (f) to introduce flexibility to the Home Assistance Loan Scheme;
- (g) to halt the sale of PRH units under the Tenants Purchase Scheme;
- (h) to relax tenancy control; and
- (i) to remove anti-speculation measures in the private property market.

7.7 On the cessation of the production and sale of HOS/PSPS flats, the Government stated that it would dispose of HOS/PSPS flats which had been completed or were under construction through market-friendly means.

7.8 On 28 November 2002, HA endorsed the recommendation to cease the production and sale of HOS/PSPS flats. It also decided that the unsold and returned HOS/PSPS flats would not be put up for sale

before the end of 2006. Some 25 000 outstanding HOS/PSPS flats had to be disposed of as at November 2002, among which were flats in the two PSPS projects of Hunghom Peninsula and Kingsford Terrace.

Overview of the Hunghom Peninsula case

7.9 The land lease of the Hunghom Peninsula development was granted to FSDL at a tender price of \$583 million in October 1999. FSDL was a wholly owned company of Wai Kee Holdings Limited ("Wai Kee") when it tendered for the development of Hunghom Peninsula in 1999. NWS, a subsidiary company of NWDCL, acquired 49% shareholding of FSDL from Wai Kee in June 2000 and increased its shareholding to 50% in July 2003. In February 2004, Sun Hung Kai Properties Limited ("SHKP") acquired 50% shareholding of FSDL from Wai Kee. NWS owned 16.5% shareholding of Wai Kee in June 2000 and increased the shareholding to 26.9% in September 2009⁴³.

7.10 According to the paper provided by the Administration, construction of the Hunghom Peninsula development, which comprises 2 470 flats, 494 car parking spaces and shopping facilities, commenced in October 1999 and was completed in 2002. With a total saleable floor area of 123 500 square metres and a per square metre guaranteed purchase price of \$15,500, the total guaranteed purchase price for all the 2 470 residential units was \$1,914 million. FSDL applied for the Consent to Sell for the project in March 2000 and it was granted in November 2002. The 20-month period for HA to nominate eligible home purchasers to purchase the flats expired in July 2004. On account of the policy for ceasing the production and sale of PSPS flats, a decision had to be made on how to dispose of the flats.

⁴³ The information on the change in shareholding in FSDL is based on the evidence of Dr Henry CHENG. According to the evidence of Dr CHENG, NWDCL owned 57% shareholding of NWS in March 2000.

7.11 The disposal options that were explored by the Government in 2002 and 2003 included: HA to purchase all the flats from the developer and dispose of them as HOS flats or guesthouses, or convert them into PRH; HA to nominate a single purchaser to take up all the flats from the developer and dispose of the flats in the private market; to obtain the developer's consent for the Government or HA to sell the flats by way of tender or auction in the open market; or to allow the developer to sell the flats in the open market subject to payment of a lease modification premium.

7.12 The Government did not consider the first three options feasible for the following reasons. The option of disposing of the flats as HOS flats would run contrary to the policy direction and adversely affect the property market. The flats were not suitable for conversion into PRH because of excessive sizes and a provision standard higher than PRH units. Furthermore, as the developer of a PSPS project held the legal title of the land and owned the entire property, disposal of the flats through nomination of a single purchaser to take up the flats or sale by tender/auction, or changing their use, required modification to the land lease with the agreement of the developer. In view of this uncertainty and the fact that the commercial and car parking facilities in the development were owned by the developer, the Government considered that the developer's agreement would unlikely be secured without protracted negotiations. The Government came to a view that allowing the developer to sell the flats in the open market subject to payment of lease modification premium was in line with the re-positioned housing policy introduced in late 2002.

7.13 On 12 November 2002, ExCo endorsed the proposal for the Administration to negotiate with the developers of Hunghom Peninsula and Kingsford Terrace. In January 2003, the Government started negotiation with the developer of Hunghom Peninsula. The negotiation was suspended around end March 2003 as an agreement could not be

reached on the premium. From April to June 2003, the Government reconsidered feasible options for disposing of the flats. In July 2003, the developer initiated litigation in the High Court⁴⁴ against the Government and HA for breaches of the terms of the contract under the Memorandum of Agreement relating to Hunghom Peninsula and claimed for damages. On 28 July 2003, SHPL submitted a file minute to CE seeking endorsement to re-open negotiation with the developer of Hunghom Peninsula. The approval of ExCo was obtained on 28 October 2003 to negotiate with the developers of the two PSPS projects for settlement of the lease modification by way of mediation. The mediation between the Government (led by LD) and the developer of Hunghom Peninsula took place from 8 to 23 December 2003 before an independent mediator. The mediation concluded with the parties agreeing on a premium of \$864 million to be paid by the developer for the lease modification and the developer to give up its right to receive the guaranteed purchase price of \$1,914 million. The mediation did not resolve the question of damages claimed by the developer in the court action. The lease modification for the lot was completed on 26 February 2004 with the developer signing and the Government approving the modified Conditions of Sale.

7.14 On 29 November 2004, NWS and SHKP made a joint announcement of their plan to demolish and redevelop Hunghom Peninsula. The announcement aroused grave public concern. On 10 December 2004, the developer announced that it would not proceed with the demolition plan after considering the controversy over the issue and the discord caused in the community.

⁴⁴ High Court Action No. 2761 of 2003.

Disposal of Kingsford Terrace flats

7.15 Kingsford Terrace⁴⁵ comprises a total of 2 010 flats, 337 car parking spaces and a shopping area of 1 880 square metres. Its construction was completed in 2003. The developer applied for the Consent to Sell in September 2001 which was granted in October 2002. The total saleable floor area of the flats was about 100 058 square metres. The guaranteed purchase price for all the flats, calculated on the basis of \$14,400 per square metre of saleable area, was about \$1,441 million. HA should nominate eligible home purchasers to purchase the flats before June 2004, i.e. within 20 months from the date of the Consent to Sell issued in October 2002.

7.16 As with the Hunghom Peninsula PSPS flats, the developer of Kingsford Terrace held the legal title to the lot and the development. The Government was faced with similar constraints as in the disposal of the Hunghom Peninsula development, and considered it logical to adopt negotiation in disposing of Kingsford Terrace. On 28 October 2003, ExCo endorsed the recommendation for the Administration to negotiate with the developer of Kingsford Terrace through mediation. At its meeting on 11 March 2004, HA's Subsidized Housing Committee ("SHC") further discussed the disposal of the Kingsford Terrace development and agreed that the best way was to negotiate with the developer through mediation to allow it to dispose of the flats in the open market subject to payment of a lease modification premium. SHC also agreed to set up a Monitoring Group to oversee and monitor progress of the negotiation and give views to SHPL on any proposed settlement for his decision.

⁴⁵ The developer of Kingsford Terrace development is Advance Planner Limited. When the Government considered the disposal of the Kingsford Terrace PPS development in 2002, the company was jointly owned by Chow Tai Fook Enterprises Limited, NWDCL and New World Services Limited.

7.17 In May 2004, the Government commenced negotiation through mediation with the developer of Kingsford Terrace. The mediation team was led by LD and reported to the Monitoring Group. The Government could not come to terms with the developer on the lease modification premium and agreement could not be reached. In order to comply with the terms of the Conditions of Sale, SHC decided on 19 May 2004 to purchase all the 2 010 residential units from the developer at the guaranteed purchase price. The purchase took place in August 2004. SHC further agreed that the Government should negotiate with the developer to purchase the non-domestic portion of Kingsford Terrace. However, the negotiation was not successful. On 18 November 2004, HA decided that the 2 010 flats should be sold under HOS in 2007. These flats were sold in Phases 1 and 2 of the Sales Programme of Surplus HOS Flats launched in 2007.

7.18 Mr LEUNG Chin-man was a member of SHC but was not a member of the Monitoring Group or the mediation team. He had attended the SHC meeting at which it was decided that HA should purchase all the residential units of Kingsford Terrace at the guaranteed price. Mr Michael SUEN said that he and Mr LEUNG were both briefed on the progress of the mediation from time to time at the Senior Directorate Meetings ("SDMs") and through reports of the mediation team.

Mr LEUNG Chin-man's role and participation in the Hunghom Peninsula case

Reorganization of policy bureaux

7.19 At the time when the process for the disposal of the Hunghom Peninsula PSPS flats was underway, a reorganization of the policy portfolios of bureaux took place within the Government following the

implementation of the Accountability System for Principal Officials on 1 July 2002. A new HPLB, headed by Mr Michael SUEN as SHPL, was established. The Bureau consisted of a new HD⁴⁶ and PLB⁴⁷. Mr LEUNG Chin-man was PSH/D of H and assisted SHPL in the formulation and implementation of housing policies and programmes. Mr John TSANG Chun-wah was the Permanent Secretary for Housing, Planning and Lands (Planning and Lands) ("PSPL") and assisted SHPL in the policy portfolio of planning and lands. Mr SUEN, Mr LEUNG and Mr TSANG assumed their posts on 1 July 2002. An organization chart of HPLB showing the key officials involved in the disposal of the Hunghom Peninsula flats is in **Appendix 12**.

Formulation of disposal options for the Hunghom Peninsula flats (from June to November 2002)

The developer's concern about the sale of Hunghom Peninsula

7.20 On 5 June 2002, Mr Donald TSANG Yam-kuen, the then CS, announced a HOS/PSPS flat sale programme for the period from July 2002 to June 2003 after expiry of the moratorium on sale of HOS/PSPS on 30 June 2002. In respect of the non-inclusion of Hunghom Peninsula PSPS flats in the programme, Mr Stewart LEUNG, on behalf of FSDL, wrote to Mr Anthony MILLER, the then D of H, on 10 June 2002 to express the developer's concern. The letter pointed out that the delay in the sale of flats would generate unexpected extra costs and losses (including rates and Government rents payable by the developer, and loss of rental income from shops and car parking spaces in the project) estimated to be \$167 million per year for the developer.

⁴⁶ The new HD was formed by the amalgamation of the former Housing Bureau and the former HD. According to the Administration, the new HD was referred to as the "Housing Branch" from time to time.

⁴⁷ PLB oversaw departments including LD, BD, PD and the Land Registry.

7.21 On 27 June 2002, Dr CHENG Yu-tung, the Chairman of NWDCL, and Mr Stewart LEUNG had a meeting with CS on the sale of the Hunghom Peninsula flats. After the meeting, Dr CHENG wrote to CS on 2 July 2002 reiterating the developer's concern and urging the Government to deal with the matter expeditiously. FSDL proposed two options for consideration by the Government:

- (a) the Government converting the flats into private flats and putting them up for sale jointly with the developer. The developer would be responsible for upgrading the development and acting as the agent in selling the flats. The developer would be entitled to the price of the flats as stipulated in the Conditions of Sale. The remaining profits after deduction of the relevant expenses would be shared between the Government and the developer; or
- (b) outright buy-out by the developer at a price to be negotiated, which technically meant modifying the land lease to allow the developer to sell the units in the open market subject to an agreed premium.

7.22 Mr LEUNG Chin-man was instructed by the CS Office to reply to FSDL's letter of 2 July 2002. Mr LEUNG replied to FSDL on 3 October 2002, pointing out that the Government would bring the matter to a mutually satisfactory resolution with the developer as soon as possible, and that he had been in close contact with Mr Stewart LEUNG on the subject.

Discussion on disposal of the Hunghom Peninsula flats

7.23 On 13 August 2002, the disposal of flats in the Hunghom Peninsula and Kingsford Terrace projects was discussed at the meeting of the Steering Committee on Land Supply for Housing chaired by SHPL.

The Steering Committee members included PSH/D of H, PSPL, Director of Lands ("D of L"), and the Deputy Secretary for the Treasury (3). Mr Marco WU Moon-hoi, the then Deputy Secretary for Housing (2), attended the meeting and introduced the following three options, set out in a discussion paper prepared by HD, for disposal of the PSPS flats in the Hunghom Peninsula and Kingsford Terrace developments:

- (a) Option A - to convince the developers to initiate lease modification for the PSPS sites with payment of land premium by the developers, by charging full market value premium, so that the flats could be sold in the open market;
- (b) Option B - the Government to buy back the PSPS flats from the developers at the pre-determined price and sell them as private flats at a later date; or
- (c) Option C - to obtain consent from the developers to initiate lease modification allowing the Government to sell all completed flats by way of tender or auction in the open market.

7.24 It was pointed out in the paper that Option A was the least problematic, would generate immediate revenue to the Government and avoid possible contractual disputes with the developers. According to the extract of minutes of the Steering Committee meeting on 13 August 2002, Mr Marco WU recommended Option A. Deputy Secretary for the Treasury (3) cautioned that the option might be criticized as favouring New World. The meeting noted that there had been precedent cases with the Government or HA selling flats to HKHS, and that allowing modification of land lease conditions subject to payment of land premium by developers was not uncommon. The meeting agreed to adopt this option. The meeting further agreed that HD would seek ExCo's

approval and take the lead in negotiating with the developers for their acceptance of the option. LD would then follow up the negotiation with the developers on the lease modification and the premium. Subsequently, ExCo endorsed the proposal at its meeting on 12 November 2002 and set a six-month time-frame for the Administration to complete the negotiation, i.e. by mid-May 2003.

Negotiation between the Government and the developer of the Hunghom Peninsula (from December 2002 to March 2003)

Negotiation on the lease modification premium

7.25 Mr Stewart LEUNG, on behalf of the developer, submitted a formal application to LD for lease modification on the Hunghom Peninsula development on 27 November 2002. He pointed out that the flats had been completed and the developer would need to make substantial improvement to the flats before selling them in the private market. LD replied to Mr LEUNG on 6 December 2002, stating that the proposed modification should achieve the objective of amending/deleting all "PSPS peculiar clauses and conditions" included in the Conditions of Sale to facilitate the disposal of the flats in the private market.

7.26 According to LD's letter dated 7 February 2003 to FSDL, LD was prepared to recommend to the Government to proceed with the proposed lease modification with a set of basic terms, and a condition that FSDL agreed to give up its right to claim against the Government, D of L, and HA in respect of any loss, damages, costs and expenses in connection with the conversion of the Hunghom Peninsula development into a private development as a result of the Government's prevailing housing policy. FSDL replied to LD on 20 February 2003 stating its acceptance in principle with the terms of the lease modification proposed in LD's letter, subject to the amount of premium being satisfactorily agreed between the Government and the developer which should take into

account FSDL's claim against the Government, D of L, and HA. FSDL also indicated that while the company agreed to enter into negotiation with the Government on the proposed lease modification, it reserved the right to claim for losses and damages from the Government on the delay in the sale of the flats.

7.27 LD commenced negotiation with the developer on the premium in January 2003. The negotiation team was led by Mr John CORRIGALL, the then Deputy Director of Lands (Specialist), who was the authority in LD for the approval of premium over \$50 million. Mr CORRIGALL told the Select Committee that he had volunteered to lead the negotiation team and considered himself suitable. He knew that the developer would be fielding "*big guns*" and he did not want his team members to feel intimidated in any way.

7.28 The developer was represented by Mr Stewart LEUNG in the negotiation. LD assessed a premium figure of around \$2,394 million and started the negotiation by proposing a premium of \$2,500 million to the developer. The approach adopted by LD was to charge the full enhancement in the market value of the lot arising from the lease modification, i.e. the robust approach. The premium figure was worked out by professional staff in the Valuation Section of LD. Factors which were taken into account in determining the lease modification premium included the transaction prices of comparable flats in the vicinity, costs to be incurred by the developer to upgrade the PSPS flats to meet the standard in the private market before sale, and the bulk purchase discount to the developer in view of the large number of flats in the development.

7.29 On 25 February 2003, Mr John CORRIGALL wrote to Mr Thomas TSO, the then Deputy Secretary (Planning and Lands)¹, with a copy to Mr LEUNG Chin-man, pointing out that the developer was only prepared to accept a premium between \$600 million and \$700 million. Mr CORRIGALL also pointed out that LD could justify a lower premium

(compared to \$2,500 million) of \$1,950 million by taking into account the marketing expenses as claimed by the developer and allowing a greater bulk purchase discount of 15%. However, Mr CORRIGALL reckoned that there was a substantial gap between the premium figures, and if an agreement could not be reached between the developer and the Government within the time-frame set by ExCo (i.e. by mid-May 2003), the Government might need to consider purchasing the flats from the developer in accordance with the lease conditions and arrange for sale of the flats in the open market by tender or auction.

7.30 In his reply to Mr John CORRIGALL on 26 February 2003, Mr Thomas TSO advised that LD was acting as the agent of HD to negotiate the premium with the developer of the Hunghom Peninsula project, and Mr CORRIGALL should report to and seek instructions from Mr LEUNG Chin-man with copy to PLB.

7.31 According to the paper provided by the Administration, the developer made a counter offer on 13 March 2003 for premium figures in the range of \$522 million to \$747 million. According to the evidence given by Dr Henry CHENG, the said figures were calculated on the basis of sale prices in the range of \$2,600 to \$2,800 per square foot having regard to the market value of nearby properties at the time and the discount to the developer owing to the unsatisfactory layout/design and shortcomings of the PSPS flats.

Suspension of negotiation

7.32 Mr John CORRIGALL reported to Mr Thomas TSO and Mr LEUNG Chin-man on 25 March 2003 on the counter premium offers made by the developer. Mr CORRIGALL was of the view that there were grounds to further reduce the premium to \$1,750 million having regard to the further weakening of the property market and allowing a slightly greater discount for inferior design and layout of the flats as well

as a slightly longer period for carrying out the upgrading works. Mr CORRIGALL considered that the figure was still much higher than the latest assessment made by the developer and a deal with the developer would unlikely be reached. He recommended halting the negotiation and suggested that consideration be given to purchasing the flats in accordance with the lease conditions and arranging for sale of the flats in the open market. He also pointed out that the developer had acknowledged the gap between the premium figures and had proposed to explore other alternatives for resolving the matter. Mr Thomas TSO replied on 26 March 2003, reiterating that Mr CORRIGALL should obtain instructions from Mr LEUNG Chin-man and keep PLB informed of the development.

7.33 As shown in an email dated 27 March 2003 from Ms Mable CHAN, Administrative Assistant to SHPL, to Mr LEUNG Chin-man and others, Mr Stewart LEUNG went to see Mr Michael SUEN on 26 March 2003 to discuss the disposal of Hunghom Peninsula. According to the email, Mr Stewart LEUNG had proposed several options to the Government including: (a) re-assessment of the premium levels by LD for further discussion with the developer; (b) appointment of separate independent surveyors by the developer and LD to assess the premium levels, the average of which would form the basis for further discussion; and (c) buying back of all the flats by the Government at the guaranteed price for sale in the open market and reimbursing the developer the cost for upgrading the flats and other administrative costs. He also mentioned that the developer would consider taking legal action against the Government as a last resort.

7.34 According to the extract of minutes of SDM⁴⁸ on 24 March 2003, Mr Michael SUEN asked Mr LEUNG Chin-man to seek internal legal advice on the viability of HA to nominating a single purchaser for

⁴⁸ The evidence relating to discussions at SDMs is based on the extracts of the relevant minutes of SDMs.

all flats in the Hunghom Peninsula and Kingsford Terrace developments. At the SDM on 31 March 2003, Mr SUEN noted the internal legal advice. He indicated that there was no intention to pursue the option, and asked LD to continue negotiation with the developer of Hunghom Peninsula on the basis of the latest premium assessment. He also agreed that LD should sound out to the developer the possibility of commissioning three independent surveyors to assess the premium levels, the average of their assessments to be binding on both parties as the agreed premium.

Communications between the Government and the developer of Hunghom Peninsula after suspension of negotiation from April to November 2003 and revisiting of the disposal options by the Government

Communications between the Government and the developer in April 2003

7.35 On 4 April 2003, Mr Vincent TONG Wing-shing, the then Deputy Director (Business Development and Construction), wrote to Mr Thomas TSO stating that PLB's continuous leading role in the negotiation with the developer of Hunghom Peninsula was essential in reaching a satisfactory agreement. In a memorandum to Mr TONG on 7 April 2003, Mr John CORRIGALL reiterated his view that there was no point negotiating further with the developer. Mr Thomas TSO replied to Mr TONG on 8 April 2003, stating that:

"All along it is your [HD's] intention to sell all the flats to the developer and charge a premium on the latter. LD has been acting as your agent to negotiate the premium with the developer. PLB is not in a position to give instructions to LD in this exercise. There is simply no land policy involved in the matter.....negotiations seem to have reached a deadlock. LD is awaiting further instructions to move forward."

7.36 According to Mr John CORRIGALL, he approached Mr Stewart LEUNG in early April 2003 to ascertain his view on the proposal of appointing three independent surveyors to evaluate the premium levels the average of which would be binding on both parties. Mr Stewart LEUNG had rejected the proposal. Mr CORRIGALL reported to Mr LEUNG Chin-man through an email on 11 April 2003, and said that LD awaited Mr LEUNG Chin-man's further instruction on the way forward. Mr LEUNG Chin-man told the Select Committee that Mr Stewart LEUNG also came to see him around that time on his rejection of Mr CORRIGALL's proposal.

7.37 Mr Stewart LEUNG told the Select Committee that Mr CORRIGALL's proposal was unacceptable to the developer because the developer could not be bound to accept any premium worked out by the three independent surveyors which might be unacceptable or unaffordable to the developer. Mr LEUNG said that given the grave concern of the developer to solve the problem, it was appropriate for him to meet any senior officials in the Government to discuss the matter at that time.

Revisiting options for disposal of the Hunghom Peninsula flats

7.38 With the negotiation having come to a standstill, it was necessary for HPLB to explore other means to dispose of the Hunghom Peninsula PSPS flats. HD prepared a number of papers in collaboration with other departments for discussion at a series of SDMs from April to June 2003. The following options were considered:

- (a) to continue negotiation with the developer with a view to narrowing the gap in premium figures of the two sides. Independent surveyors would be engaged to find a

reasonable and mutually acceptable figure, while justifiable concessions might have to be made;

- (b) to nominate a single purchaser to purchase all the flats from the developer; or
- (c) HA to purchase all the flats at the guaranteed price of \$1,914 million by the end of the 20-month period and to sell or rent them out for use as service apartments, guesthouses or time-share accommodation, or to convert the flats into PRH.

7.39 The papers analyzed the merits of continuing negotiation with the developer of Hunghom Peninsula and pointed out many problems associated with the other options, such as difficulty in waiving the restrictions for the nominated purchasers to resell the flats; complications involved in converting the flats into service apartments, guesthouses or time-share accommodation; and the anticipated lower premium to be fetched. The papers concluded that the breakdown in negotiation with the developer would result in substantial financial loss to the Government.

7.40 As regards the option of nominating a single purchaser to purchase all the flats from the developer, the SDM on 31 March 2003 had considered the internal legal advice obtained on the option. The option was revisited at the SDM on 28 April 2003. Mr LEUNG Chin-man opined that consideration could be given to lifting the restriction in HO on resale of flats to facilitate the resale arrangement by the single purchaser. Mr Michael SUEN took the view that it was necessary to confirm the legal viability of the single purchaser option expeditiously. Pursuant to the meeting, the Government sought outside legal advice regarding the viability of the single purchaser option.

7.41 The option of nominating a single purchaser was discussed again at the SDMs on 12 and 19 May 2003. According to a paper for the SDM on 12 May 2003, the option would not require modification of the lease, and the restriction under HO on further alienation by the single purchaser could be dealt with by administrative means. Under the option, the carpark and commercial facilities within the same lot together with the initial management right would still be held by the developer. On the other hand, the paper pointed out that there were a number of problems associated with the option which could affect its viability. These included: (a) the inferior legal titles of the flats sold under this option as the restrictive PSPS terms would still remain; (b) other developers might have doubts over the practicality of the option both legally and administratively which, together with the large volume of the property, would raise the risk and lower the flat price; and (c) LD's reservations over the legal feasibility of the proposed arrangement to get around the constraint on alienation imposed by HO.

7.42 On 20 May 2003, Cheung, Chan & Chung Solicitors & Notaries ("Messrs Cheung, Chan & Chung"), i.e. the developer's solicitors, issued letters to CE, Mr Michael SUEN, Mr LEUNG Chin-man and Mr Patrick LAU (the then D of L) indicating that they intended to claim against the Government and HA for damages, extra costs, and losses in the order of \$167 million per year for the delay in nomination of purchasers for the Hunghom Peninsula PSPS flats.

7.43 According to the Government's in-house lawyers and outside Senior Counsel, the option of nominating a single purchaser to take up the Hunghom Peninsula PSPS flats could be considered as providing housing to the general public and as such HA could be challenged for acting outside its authority and powers under HO. Moreover, such option was also outside the terms of the relevant Conditions of Sale and might be subject to claims by the developer. At the SDM on 26 May 2003, Mr Michael SUEN said that the best way forward was to conclude

a deal with the developer expeditiously in view of the legal advice obtained on the single purchaser option and the time constraint. LD estimated that the revised premium could be reduced to \$1,400 million if negotiation with the developer was re-opened.

Resumption of negotiation with the developer

7.44 At the SDM on 9 June 2003, HD put forth the following three options for consideration at the meeting:

- (a) to continue negotiation with the developer on the amount of premium with a view to reaching an agreement early;
- (b) to secure the developer's consent to modify the lease such that HA's involvement would be removed and the Government could sell the flats to a single purchaser through open tender; or
- (c) HA to take up all the flats at the guaranteed price and explore different disposal options.

7.45 At the SDM on 9 June 2003, Mr LEUNG Chin-man commented that the option in (c) might be viewed as contrary to the policy on cessation of the production and sale of HOS and PSPS flats if HA would eventually have to dispose of the flats in the market. Mr Michael SUEN instructed that a paper setting out the implications of the options be prepared for his discussion with CE.

7.46 In a paper prepared for the SDM on 16 June 2003, it was recommended that negotiation with the developer be resumed by taking a new strategy with a view to reaching a commercial settlement, including the agreement of an equitable land premium to modify the land lease so as to release HA's obligations and allow the developer to sell the flats in

the open market. According to the paper, LD considered that for a realistic chance of reaching a settlement, it would be necessary to depart from the robust approach in assessing the lease modification premium. It was also suggested in the paper that the Government might adopt a flexible approach in assessing the extra costs incurred by the developer and the level of bulk purchase discount in order to achieve a settlement.

7.47 At the SDM on 16 June 2003, Mr Michael SUEN pointed out that the feasible option was to resume negotiation with the developer with a view to reaching a commercial settlement as early as possible. Mr LEUNG Chin-man stated that the matter should be handled carefully so as not to attract criticism that the Government/HA had shown favouritism towards the developer. He also pointed out that the Administration might need to seek further advice from ExCo when a decision on the proposed way forward was made. Mr SUEN also mentioned the need for the Government to formulate a public relations strategy to take forward the matter.

7.48 In an email to Mr Vincent TONG on 27 June 2003, Mr John CORRIGALL stated that, as it was the Government which had sought to change the lease relating to the Hunghom Peninsula development, it seemed unreasonable for the Government to seek full increase in value arising from the lease modification from the developer as the latter had expected all the usual PSPS terms would be followed and did not wish to change. He considered it not unreasonable for the Government to share the increase in value of the lot with the developer by charging it 50% of the premium ("the 50/50 proposal"). He mentioned that LD had settled a couple of cases in the past at 50% premium where there were doubts on the ability to require a lease modification and at least one such case was discussed at ExCo. According to the documents produced to the Select Committee by Mr CORRIGALL, there were three cases where it was decided that to accept 50% premium was a better option than to go to litigation with the risk of getting no premium and having to pay costs as

well. These cases were at Fuk Lo Tsuen Road, Kowloon City; Tak Fung Street, Hunghom; and a redevelopment proposal at Tai Uk Wai, Tsuen Wan.

7.49 Mr Vincent TONG introduced the 50/50 proposal at the SDM on 30 June 2003. Mr LEUNG Chin-man suggested that the Government should re-start negotiation with the developer as early as possible on public interest ground. He mentioned the need for the Government to manage public perception that a fair deal had been concluded between the Government and the developer, and to put in place a suitable public relations strategy to back up the case. He also considered that there was no need to seek further advice from ExCo having regard to the latter's decision in November 2002. Mr Michael SUEN said that he would take a further view on the matter having regard to ExCo's previous decision, and would brief CE on the suggested way forward.

7.50 On 25 July 2003, the developer issued a writ to claim damages from HA and the Government arising from the delay in nomination of purchasers for the flats in the Hunghom Peninsula development. Mr Stewart LEUNG told the Select Committee that the Government had not responded to the counter premium offers made by the developer in March 2003, and the property market had further plummeted as a result of the outbreak of Severe Acute Respiratory Syndrome in February/March 2003. The developer was anxious to recover all money incurred in the project. Upon receiving legal advice, the developer issued the writ of summons against the Government and HA in July 2003.

7.51 On 28 July 2003, Mr Michael SUEN submitted a file minute to CE seeking his instructions on the way forward for the disposal of the Hunghom Peninsula and Kingsford Terrace PSPS projects. In the minute, Mr SUEN pointed out the huge gap between Government's offer and the developer's indicative premium figure over the lease modification of the Hunghom Peninsula development. He also mentioned the options

studied by the Government including nomination of a single purchaser to take up the flats and HA buying back the flats at the guaranteed price, and that the developer of Hunghom Peninsula had initiated litigation against the Government and HA. Mr SUEN put forward two options for the Hunghom Peninsula development: (a) to re-open negotiation with the developer; or (b) to modify the lease conditions removing the PSPS restrictions, and the developer to upgrade the flats, sell the units and recoup the guaranteed price and related costs, whereupon the Government would recoup the profit HA would have made, had PSPS purchasers been nominated, from the sales proceeds with any surplus sales proceeds being shared. Mr SUEN recommended adoption of option (a) and seeking a settlement with the developer on a 50% premium basis.

7.52 In early October 2003, CE directed that the matter be submitted for discussion at ExCo. At the ExCo meeting on 28 October 2003, approval was given for the Administration to negotiate on the Hunghom Peninsula and the Kingsford Terrace developments by way of mediation to seek expeditious settlement with the developers and to allow the developers to put up the flats for sale in the open market subject to payment of agreed premiums. In respect of the Hunghom Peninsula development, ExCo's decision was for the Administration to be given the authority to settle the case at \$1,150 million to achieve a global settlement of all the related issues including the lease modification premium, the alleged damages and the guaranteed price; anything lower than that figure was to be approved by SHPL. According to an email dated 24 November 2003 from Mr CORRIGALL to Mr LEUNG Chin-man, the figure of \$1,150 million was arrived at on the basis insisted by the Financial Services and the Treasury Bureau, i.e. a 70/30 split between the developer and the Government based on the full market value premium assessed at that time, instead of the 50/50 split proposed by LD.

Preparation for the mediation with the developer

7.53 On 30 October 2003, Mr LEUNG Chin-man chaired a meeting held at the office of DoJ, with the attendance of Mr John CORRIGALL, Mr Vincent TONG and others. Mr LEUNG said at the meeting that the scope of the mediation was to cover matters relating to the Hunghom Peninsula development, and the client for the mediation was SHPL with delegated authority from ExCo. The Government mediation team ("the Mediation Team") would be led by Mr CORRIGALL and comprised representatives from LD, HA/HD and DoJ⁴⁹. Mr LEUNG, as PSH/D of H, would act on behalf of SHPL and give instructions to the Mediation Team. According to Mr Stewart LEUNG's evidence, he headed a team representing the developer in the mediation.

7.54 On 31 October 2003, Mr LEUNG Chin-man sent an email to Mr John CORRIGALL informing him of SHPL's agreement that the Mediation Team could decide on the settlement amount with the assistance of the mediator, and in the event that the team intended to settle at an amount below \$1,150 million, it should refer the matter to SHPL for decision. Mr LEUNG also stated that:

"Given that I have completed the first communications with the other side, I will not be taking any part in the negotiation process personally from now on. Vincent

⁴⁹ Members of the Government mediation team included-

- (a) LD: Mr John CORRIGALL (Deputy Director(Specialist)), Mr Anthony Lucas ROBERTSON (Assistant Director/Legal (Kowloon and Conveyancing)), Ms Susan KU Pik-so (Senior Estate Surveyor/Valuation 3);
- (b) HA/HD: Mr Vincent TONG (Deputy Director (Business Development & Construction)), Ms Peggy CHAN Siu-ling (Chief Estate Surveyor (PSPS & Tenant Purchase Scheme)), Mr CHAN Nap-ming (Chief Manager/Business Development), Ms Handa LAM Ching-fan (Assistant Legal Advisor), Mr Santiago CHUEN Kwok-wai (Senior Finance Manager/Business Management & Support (2)); and
- (c) DoJ: Mr Gregory PAYNE (Senior Government Counsel), Mr Enzo CHOW Wai-hung (Government Counsel).

TONG will of course be accountable to me for anything that may affect the interest of the HA. Apart from that, I will not be involved in this exercise."

7.55 In response to the Select Committee about his "*first communications*" with the developer, Mr LEUNG Chin-man said that he might have called Mr Stewart LEUNG for more than once on 28 and 29 October 2003 to inform him of the mediation arrangement and the composition of the Mediation Team. He pointed out to Mr Stewart LEUNG that he would not be involved in the actual negotiation of the premium for the lease modification and told Mr LEUNG not to contact or call him during the mediation period. According to Mr Stewart LEUNG, he did not have any formal or informal discussions with Mr LEUNG Chin-man on the disposal of the Hunghom Peninsula development during the mediation period.

7.56 On 5 November 2003, Messrs Cheung, Chan & Chung wrote to DoJ and made a premium offer of \$700 million on behalf of the developer for the Government's consideration. On 12 November 2003, DoJ replied to Messrs Cheung, Chan & Chung stating that the Government was under a mandate to resolve the dispute with the developer through mediation and the mediation would be proceeded on a global settlement basis (i.e. settlement of the lease modification premium and all outstanding issues arising out of the Hunghom Peninsula development).

7.57 In an email on 10 November 2003, the Mediation Team sought Mr LEUNG Chin-man's views on the recommended mediator to conduct the mediation, and the recommendation of appointing a valuer to act as advisor to the mediator. In his reply on 11 November 2003, Mr LEUNG said that he would leave such matters entirely to the Mediation Team and would not want to be involved in the mediation process unless the Team considered it necessary to go below the bottom line of \$1,150 million, in

which case reference would need to be made to SHPL and he would be consulted on the matter by SHPL.

Mediation between the Government and the developer on the disposal of the Hunghom Peninsula development (in December 2003)

The mediation process

7.58 The mediation commenced on 8 December 2003 and concluded on 23 December 2003 before an independent and accredited mediator. During the mediation process, Mr John CORRIGALL filed reports to Mr LEUNG Chin-man via emails on the progress, the various elements of the premium assessment that the parties had discussed and the outcome. Mr CORRIGALL also copied the reports to D of L.

7.59 In his email dated 10 December 2003 to Mr LEUNG Chin-man, Mr John CORRIGALL reported that the developer had made a revised premium offer of \$864 million and both sides had not touched on the issue of damages. He sought Mr LEUNG's agreement to point out to the developer at the next session that although the developer's premium offer was substantially below its assessment, the Mediation Team was willing to proceed to explore the developer's breakdown of the offer to see if the premium could be increased and then discuss the issue of damages. The Mediation Team considered that the chance of seeking the developer to increase the offer significantly and offer a global sum at or above the ExCo approved figure for settlement was very slim. Mr CORRIGALL was of the view that if a settlement was to be reached, it was almost certain that SHPL's authority had to be sought. In another report made on 13 December 2003, Mr CORRIGALL informed Mr LEUNG Chin-man that there were inconsistencies in the breakdown of the developer's premium offer of \$864 million. LD considered that the figure should be \$955.5 million, and the developer had refused to increase the amount. On the other hand, the developer had indicated an

amount of around \$250 million as the damages claimed in the litigation. Mr CORRIGALL pointed out that by deducting \$250 million from \$955.5 million, the figure would be close to the \$700 million proposed by the developer in early November 2003 before the commencement of the mediation.

7.60 On 18 December 2003, Mr John CORRIGALL sent an email to Mr LEUNG Chin-man which was copied to Ms Mable CHAN. Mr CORRIGALL pointed out that given the huge damages claimed by the developer, the Mediation Team had explored with the developer whether it would be willing to go ahead with the lease modification at a premium of \$864 million, with the question of damages deferred for further negotiation or resolved through litigation. He also pointed out that the developer had put forward a revised damages claim of \$264 million. Moreover, Mr CORRIGALL advised that it was justifiable for the Government to accept the premium amount of \$864 million. He explained that if the Government's latest premium assessment was to be slightly revised (i.e. the Government to slightly revise the assessed premium after making minor concessions in the light of the factors raised by the developer including deferments, costs of upgrading the flats and marketing costs), the premium amount of \$864 million would be close to 50% of the revised premium assessment. He further pointed out that the 50/50 split of the premium had been taken on board by Mr Michael SUEN in his minute submitted to CE. Mr CORRIGALL said that as settlement at a figure below \$1,150 million would require SHPL's authorization, he sought Mr LEUNG Chin-man's agreement to continue the mediation on that basis. Mr CORRIGALL also gave his views on the advantages for the Government to settle the lease modification premium without agreement on damages as follows:

- (a) it would obviate the need for HA to pay \$1,914 million to purchase all the flats which remained subject to the PSPS

conditions that could not be removed without the developer's agreement;

- (b) it would set a limit on the period for which the developer could claim to have suffered losses due to the alleged failure of HA to nominate purchasers for the flats;
- (c) the Government could collect a lease modification premium of \$864 million; and
- (d) the question of damages could be objectively assessed by the Court.

7.61 On 24 December 2003, Mr John CORRIGALL reported the situation to Mr LEUNG Chin-man via email which was also copied to Ms Mable CHAN. He reported that the developer agreed to go ahead with the lease modification at a premium of \$864 million. As regards the developer's damages claim, Mr CORRIGALL pointed out that there were inherent difficulties in reaching an agreement on the issue, including the Government/HA having to assume that the developer had established a breach on the part of the Government/HA. He sought SHPL's authority through Mr LEUNG to settle the lease modification at the premium of \$864 million which excluded the developer's damages claim. He also reiterated his views contained in his email of 18 December 2003 about the advantages for such approach taken by the Government. Given that the agreement to be reached with the developer was not "a global settlement", Mr CORRIGALL raised the question as to whether it was necessary to obtain ExCo's approval.

7.62 In his email to Mr Michael SUEN at 11:13 am on 27 December 2003 (to which Mr CORRIGALL's email on 24 December 2003 was attached), Mr LEUNG Chin-man suggested that Mr SUEN accept Mr CORRIGALL's recommendation for acceptance of the developer's

premium offer of \$864 million for settlement of the lease modification. Mr LEUNG said that:

"I think our negotiation team [the Mediation Team] have made their best endeavours to fetch a fair deal for the government and HA. It is clear, and in a way fortunate, that the developer's view on the premium i.e. a 50/50 split is close or almost identical to that of Corrigall at the very beginning, bearing in mind that HA's failure to nominate purchasers upon completion of the flats is subject to clear and serious legal challenge and the developer's knowledge that we do not want to purchase this property the disposal of which is entirely at their mercy. In fact, I find it rather amazing that the developer is prepared to come this far."

He also considered that:

"The present premium figure is defensible, and indeed it would look much more shabby if we settled on a global figure i.e. with a considerable sum for the damages being deducted from the premium. In the latter case, we would never be able to explain to the public about the two separate components [the premium and claim for damages], and the relatively low premium figure will give our critics a field day on this case."

7.63 Mr LEUNG Chin-man told the Select Committee that it was his duty as PSH/D of H to put forward his analysis and views on the recommendation made by Mr John CORRIGALL. As regards whether ExCo's endorsement for settlement at the premium of \$864 million was required, Mr LEUNG Chin-man told the Select Committee that he pointed out to Mr Michael SUEN in his email on 27 December 2003 that

Mr SUEN had been authorized to decide on the premium, irrespective of the "bottom line" set in the submission to ExCo in October 2003, and the only condition imposed by ExCo was that the negotiation should proceed with the aid of a mediator. Therefore, Mr LEUNG considered that there was no need to seek further approval from ExCo and advised Mr SUEN that he as SHPL had the authority to make the decision.

7.64 Mr Michael SUEN replied to Mr LEUNG Chin-man's email at 11:30 am on the same day. Mr SUEN told the Select Committee that having gone through the report from Mr John CORRIGALL, he accepted in full the recommendation put forward with regard to the reasons mentioned by Mr LEUNG in the latter's email. On the need for the Administration to consult ExCo again, Mr SUEN considered that he had ExCo's delegated authority to conclude the deal and decided to accept the developer's premium offer of \$864 million. As to why Mr SUEN had made his decision in as short as 17 minutes after receiving the email, he explained to the Select Committee that he was aware of the progress of mediation between the Government and the developer as Mr CORRIGALL's reports on the last two mediation sessions were copied to his Administrative Assistant, Ms Mable CHAN.

7.65 According to the Administration, the premium of \$864 million accepted by the Government was the result of the mediation and not based on a 50/50 or 70/30 split of the premium between the developer and the Government. In response to the Select Committee at the hearing, Mr Michael SUEN said that when the Government decided to re-open negotiation with FSDL, it had considered the huge difference between the premium figures of both sides and decided that mediation be conducted with a view to reaching a commercial settlement. By taking this approach, both parties would have to make concessions and compromise on a mutually agreed figure.

7.66 On 26 January 2004, the Government and the developer reached a preliminary agreement on the lease modification of the Hunghom Peninsula development to amend the Conditions of Sale⁵⁰ allowing the flats to be sold in the open market. In return, the developer agreed to give up its right to receive the guaranteed purchase price at \$1,914 million from HA and to pay a premium of \$864 million for the lease modification. The details of the lease modification for the Hunghom Peninsula development were set out in an offer letter dated 21 January 2004 from D of L to Messrs Cheung, Chan & Chung. The lease modification process was completed on 26 February 2004.

7.67 The drawing up of provisions in the modified land lease was under the purview of LD. Mr John CORRIGALL said that the matter was handled by other senior officers in LD and he was not involved; the other departments including HD, Transport Department, Architectural Services Department and PD were also invited to give comments. Mr LEUNG Chin-man also told the Select Committee that he was not involved in the matter.

Settlement of the lease modification premium at \$864 million

7.68 In response to the Select Committee on the premium of \$864 million offered by the developer, Mr Stewart LEUNG said that the developer had revised its offer from \$700 million made in early November 2003 to \$900 million when the mediation with the Government commenced. The premium offer of \$900 million had taken

⁵⁰ Clauses 11(a) and 11(b) in the Special Conditions on "Restrictions on development or redevelopment" had remained unchanged. In accordance with Clause 11(a), "the lot or any part thereof shall not be developed or redeveloped except in accordance with these Conditions, the Master Layout Plans and the Approved Landscaping Proposals and no building or structure which is not shown on the Master Layout Plans and the Approved Landscaping Proposals shall be erected, constructed or maintained on or within the lot." Clause 11(b)(i) stipulated that "the total gross floor area of any building or buildings erected or to be erected on the lot designed and intended to be used for private residential purposes, shall not exceed 144 300 square metres."

into account the market value and trend of neighbouring residential units, the sale and purchase transactions in the vicinity of the Hunghom Peninsula development between November 2002 and December 2003, and the drawbacks of the Hunghom Peninsula being a PSPS development. Mr LEUNG pointed out that the lease modification would result in the loss of 100 car parking spaces being used for conversion into a club house, and with the value for each car parking space being assessed at \$360,000, \$36 million was deducted from \$900 million to arrive at \$864 million.

7.69 In response to the Select Committee at the public hearing on 17 November 2009, Dr Henry CHENG said that the developer might have made a profit of about \$2,000 million to \$3,000 million from the sale of Harbour Place⁵¹ flats in the private market. He said that the profit was not related to the premium of \$864 million. The developer could not have possibly foreseen in 2003 the profit that could be fetched from the flat sale in 2008 and 2009. He indicated that during the mediation in late 2003, the developer in fact considered that the offered premium of \$864 million was on the high side, and this was the main reason why NWS had refused to purchase the other 50% shareholding in FSDL from Wai Kee in early 2004. Dr CHENG said that the developer was willing to offer the premium of \$864 million as it wanted to resolve the matter expeditiously and get back its investment in the project as soon as possible after selling the flats. He pointed out that the developer had spent almost \$2,000 million on the project. It would be commercially sound to accept the Government's proposal to modify the land lease to avoid further delay and recover the money incurred.

7.70 At the hearing on 20 July 2009, the Select Committee asked Mr LEUNG Chin-man that given that the resultant premium of \$600 million (after deducting the estimated damages of \$250 million in

⁵¹ Please refer to footnote 17 of paragraph 5.15.

the Hunghom Peninsula litigation from \$864 million) was quite favourable to the developer, whether he agreed with Mr Michael SUEN's statement made at the hearing on 14 July 2009 that the public had grounds to suspect that there was deferred benefit in his employment with NWCL. Mr LEUNG Chin-man told the Select Committee that his recommendation to Mr SUEN was based on Mr John CORRIGALL's analysis and recommendation that "*it makes perfect sense to accept the developer's offer*". He considered Mr CORRIGALL's proposal reasonable and also agreed with Mr CORRIGALL that from the perspective of public interest, it was the best agreement that could be reached under the circumstances at that time. Mr LEUNG also considered that it would be easier to explain to the public by separating the lease modification premium from the damages claimed by the developer in the Hunghom Peninsula litigation, and he considered it misleading to say that the premium actually fetched was \$600 million with deduction of the estimated damages of \$250 million since the damages claimed by the developer was a matter pending the court's determination in an outstanding litigation. Mr LEUNG further said that he would not make any comments on Mr SUEN's personal view and reiterated that he had acted impartially and had not done anything contrary to the proper procedures or against his own conscience in the premium issue. Mr LEUNG admitted that he had intensive participation in the Hunghom Peninsula case, but considered that it did not mean that he had done anything wrong in the matter.

7.71 The Select Committee asked Dr Henry CHENG whether it was the developer's intention at the outset to buy out the Hunghom Peninsula PSPS flats for sale in the private market knowing that this could yield the greatest profit for the developer. In response, Dr CHENG pointed out that in addition to the buy-out option, the developer had proposed other options to dispose of the Hunghom Peninsula flats for consideration of the Government, including converting the flats into private flats and putting them up for sale jointly with the Government, and the

Government buying back the flats at the guaranteed price. Dr CHENG said that the Government buy-back option had been provided in the Conditions of Sale, and thus only the developer buy-out option and the joint-sale option had been included in Mr Stewart LEUNG's letter to CS on 2 July 2002. Dr CHENG also said that he understood that there were difficulties for the Government to pursue the buy-back option given that it had announced the policy on ceasing the production and sale of HOS and PSPS flats.

7.72 On the joint-sale option, both Dr CHENG and Mr Stewart LEUNG told the Select Committee that the developer considered it more advantageous to the Government as it involved the least efforts from the latter. As for the Government's position of not accepting the option, it was Mr Stewart LEUNG's impression at that time that the Government was concerned about possible public perception of collusion between the Government and the developer. On the buy-back option, Mr Stewart LEUNG said that the Government had never told the developer that it would not buy back the Hunghom Peninsula PSPS flats. He disagreed with Mr LEUNG Chin-man's remarks in the latter's email of 27 December 2003 to Mr Michael SUEN that the developer had knowledge that the Government did not want to purchase the PSPS flats. Mr Stewart LEUNG understood that the Government had the right to buy back the flats and could achieve this through various means.

7.73 In response to the Select Committee on whether the Government was at a disadvantageous position and had no bargaining chips in the premium negotiation, Mr John CORRIGALL replied that he considered this to be the case.

7.74 The Select Committee has asked for the reason why the Administration had not adopted the buy-back option in the Hunghom Peninsula case as it had done for the Kingsford Terrace development in mid 2004. Mr Michael SUEN gave evidence that when the Government

considered the disposal of the Hunghom Peninsula development, HA was facing serious financial difficulties which were attributed mainly to two outstanding court cases at that time, namely on HA's decision to defer the review of public housing rents and on the public listing of The Link REIT. If HA lost in both court cases, there would be serious implications on the financial position of HA. Mr SUEN said that the worst scenario forecast at that time was that HA would be on the brink of bankruptcy, and thus would not be in a position to buy back the flats in the Hunghom Peninsula development at the guaranteed price. According to the financial outlook of HA in early 2003, the projected cash balance for 2005-2006 was at a deficit of \$5,491 million. Mr SUEN pointed out that HA's financial outlook had improved significantly in early 2004. The revised projection showed a surplus of \$14,985 million following inclusion of the expected cash inflow arising from the listing of The Link REIT.

Developer's plan to demolish and redevelop the Hunghom Peninsula development

7.75 Dr Henry CHENG gave evidence that after the conclusion of the premium negotiation with the Government, SHKP bought the 50% interest in FSDL owned by Wai Kee in February 2004. According to Mr Stewart LEUNG, it was SHKP which suggested redeveloping the Hunghom Peninsula development and NWS did not object to the proposal. Since it became a shareholder of FSDL, SHKP had taken over the role of the Project Manager of the development and was responsible for the communications with the Government relating to the redevelopment plan. According to the information provided by SHKP in response to the Select Committee's request, redevelopment of the Hunghom Peninsula development was among the options considered by SHKP for achieving the overall objective of maximizing the financial return for its investment in the project. SHKP acted as the Project Manager of the project after its acquisition of a 50% shareholding in FSDL. The decision of

redeveloping the project was made by SHKP and NWS shortly before the announcement of the redevelopment plan on 29 November 2004.

7.76 As to the reason for proposing to redevelop the Hunghom Peninsula development, Dr Henry CHENG told the Select Committee that it was a commercial decision. He pointed out that the development was a PSPS project which was not attractive in the private property market. The costs for upgrading the interior and exterior of the development to make it marketable and attractive would cost more or less the same as redevelopment. Dr CHENG said that the developer considered it more sensible and commercially worthwhile to redevelop the project. He further considered that the Government had no ground to restrict the redevelopment of the Hunghom Peninsula development. Dr CHENG understood that a lease modification involving premium payment from the developer might be required for the plan. He pointed out that as the redevelopment plan had aroused public concern, the developer had subsequently cancelled the plan in order to maintain community harmony.

7.77 As regards the time when the Government became aware of the developer's plan to redevelop Hunghom Peninsula, Mr Michael SUEN and Mr John CORRIGALL gave evidence that LD received letters on 31 January 2004 and 11 February 2004 from Messrs Cheung, Chan & Chung requesting further modification of the Conditions of Sale (including, inter alia, deletion of Special Condition 11(a) which required development and redevelopment to accord with the approved Master Layout Plans and Approved Landscaping Proposals). Mr SUEN said that although the letters did not disclose the reason for seeking further modification, LD considered that the proposal was to facilitate redevelopment. As LD held the view that the further modification proposed by the developer was not necessary to achieve the aim of allowing the developer to sell the flats in the private market, it rejected

the request vide its letter dated 12 February 2004 to Messrs Cheung, Chan & Chung.

7.78 Mr Stewart LEUNG explained to the Select Committee that the amendments proposed by the developer in the lease modification of the Hunghom Peninsula development in 2003 were mainly for converting the PSPS development into a private housing development for sale in the open market. Dr Henry CHENG told the Select Committee that after the conclusion of the premium negotiation with the Government in December 2003, the developer discovered that the terms and conditions in the land lease should be further amended to provide it with more flexibility in selling the flats in the private market. Consequent upon LD's rejection of the proposal, the developer had not insisted on the matter and signed the modified land lease in February 2004.

7.79 Having regard to press reports about the possible demolition of the Hunghom Peninsula development, the Director of Environmental Protection wrote to NWDCL and SHKP on 3 March 2004 urging them to avoid demolishing Hunghom Peninsula. In SHKP's reply dated 16 March 2004, the company pointed out it was discussing with its partner in the Hunghom Peninsula project possible options for the project and demolition was among the various options being considered.

7.80 The possible redevelopment of the Hunghom Peninsula development was discussed at a number of SDMs held in April to November 2004. On 5 July 2004, LD wrote to Messrs Cheung, Chan & Chung reiterating LD's rejection of the developer's request made in January 2004 for further modification to the Conditions of Sale which was geared to allowing redevelopment of the lot. Following the joint announcement made by NWS and SHKP on 29 November 2004 on their plan to demolish and redevelop the Hunghom Peninsula, LD further wrote to Messrs Cheung, Chan & Chung on 7 December 2004, pointing out that redevelopment of the lot would not be permitted except in

accordance with Special Condition (11)(a) in the Conditions of Sale, and the consent of D of L had to be obtained before the commencement of building works following demolition as required under General Condition 7(b). On 10 December 2004, NWS and SHKP jointly announced the cancellation of the redevelopment plan. In November 2005, the developer applied for a lease modification to facilitate major upgrading works in the Hunghom Peninsula. It subsequently submitted a smaller scale upgrading proposal. The lease modification for the proposal was concluded at a premium of \$36.99 million in November 2007.

7.81 Mr Michael SUEN gave evidence that the proposed redevelopment of the Hunghom Peninsula development and subsequent alteration and additional works undertaken by the developer were subjects outside the purview of HB. BD and LD were involved to ensure that the developer would comply with all statutory requirements and lease conditions. He said that he did not expect and was not aware of Mr LEUNG Chin-man's involvement in the matters except for the fact that he was informed of the progress during SDMs as a member of SDM. Mr LEUNG Chin-man also told the Select Committee that he was not involved in the discussions within the Government on matters relating to the developer's plan to redevelop the Hunghom Peninsula development, and he had no discussion with the developer on the matter. Mr John CORRIGALL gave evidence that his involvement in the discussion between the Government and the developer on the latter's redevelopment plan was minimal given that mainly legal issues were involved, i.e. essentially on whether or not the requirement to redevelop in accordance with the Master Layout Plans under the Conditions of Sale would restrict any redevelopment. He said that there had been some discussion between his colleague, Mr Anthony ROBERTSON, and Mr Stewart LEUNG on the matter.

7.82 The foregoing sequence of events and developments shows Mr LEUNG Chin-man's role and participation in the Hunghom Peninsula case. In order to ascertain whether there was any connection between Mr LEUNG's role and participation in the Hunghom Peninsula case and his taking up of the post-service work with NWCL that might have given rise to conflict of interest, the Select Committee considers it necessary to examine further the relationship between Mr LEUNG Chin-man and some other related witnesses, and the evidence given by Mr LEUNG himself regarding his role and participation in the Hunghom Peninsula case and his employment with NWCL. These matters will be covered in Chapter 8.