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YOUR REF

DATE 20th May 2003

OUR REF PC/LC/37000/03

PLEASE REPLY TO Mr. Leo Cheng

URGENT

- TO: (1) THE CHIEF EXECUTIVE OF THE HKSAR
(2) THE SECRETARY FOR HOUSING, PLANNING & LANDS
(3) THE HOUSING AUTHORITY
(Attn.: Mr. Leung Chin Man, JP)
(4) THE LANDS DEPARTMENT
(Attn.: Mr. Patrick Lau Lai Chiu, JP)

**PRIVATE &
CONFIDENTIAL**

Dear Sirs,

Private Sector Participation Scheme - Hunghom Peninsula
Kowloon Inland Lot No.11076 ("the Lot"),
Hunghom Bay Reclamation Area, Kowloon, Hong Kong ("the Project")

We act for First Star Development Limited ("our client") and refer to the Project developed by our client ("the Development") pursuant to the Private Sector Participation Scheme.

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PARTNERS:

Cheung King Poon, Derek	LL.B	張景端律師	2522 4986
Cheng Huen Ming, Leo	LL.B	鄭煒明律師	2530 5262
Leung Chun Kuen, Noel	LL.B	梁振權律師	2230 2033

ASSOCIATES:

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Wong Siu Mei, Simee	LL.B	王少薇律師	2230 2013
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CONSULTANTS:

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We would wish to point out the following:

1. The Private Sector Participation Scheme ("PSPS Scheme") was established by the Government in around 1979 for the purpose of assisting Hong Kong residents who fulfilled certain financial criteria set down by the Hong Kong Housing Authority ("the Housing Authority") under its statutory duty, to purchase their own homes at subsidized prices. The PSPS Scheme basically operated as follows: -

(1.1) The Government invited tenders from proposed developers to lease a particular lot of land for a fixed term of years. Under the PSPS Scheme, the successful tenderer ("the Developer") would build and manage a residential estate to certain specifications laid down by the Government.

(1.2) The Housing Authority would determine to whom the Developer could sell each residential unit and at what price. The Developer would nevertheless receive a fixed price agreed in the contract.

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- (1.3) The Developer was prohibited from selling any of the residential units on the open market, and could only sell to purchasers nominated by the Housing Authority.
- (1.4) The Developer was permitted to build certain units for commercial purposes and free to sell the same on the open markets. However, the market reality was that the marketability of the commercial units was obviously linked to the sale of the residential units.
- (1.5) Before the Developer could assign or agree to assign any of the residential units:-
 - (a) Pre-sale Consent had to be granted by the Director of Lands; and
 - (b) The Housing Authority had to nominate a purchaser to purchase a specified residential unit from the Developer.
- (1.6) Previously, the invariable practice that had always been observed under the PSPS Scheme ("the PSPS Practice") and which were implied terms of the contract were that:-

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- (a) All parties including the Government and the Housing Authority would endeavour to facilitate and complete the entire development and sale of all the units as soon as possible and without delay;
- (b) No party would act deliberately in any way to thwart, obstruct, frustrate or delay the process and progress of either the development of the project or the sale of the units; and
- (c) The Director of Lands would grant Pre-Sale Consent, and the Housing Authority would use its utmost endeavours to nominate purchasers to purchase the residential units, as soon as possible and without delay. Indeed, in the past, the practice was that the grant of Pre-Sale Consent and nomination of purchasers would be done prior to the completion of construction and before the granting of the Occupation Permit or Certificate of Compliance.

2. Pursuant to the PSPS Scheme, and on the basis of the PSPS Practice, our client submitted a Form of Tender on 25th June 1999 which included its offer to obtain a grant of the Lot at a premium of HK\$583 million subject to the General and Special Conditions of Sale annexed thereto ("the Tender").

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3. Following our client's successful tender, it entered into a Memorandum of Agreement dated 22nd October 1999 ("the Memorandum of Agreement") with the Government of the HKSAR and became the Lessee of the Lot. This Memorandum of Agreement contains the implied terms referred to herein in order to give it business efficacy.
4. In the circumstances, our client tendered for the Lot and thereafter entered into the Memorandum of Agreement on the basis of the PSPS Practice, and the implied terms referred to herein on which it had based its tender price and critical calculations for the related financial arrangements for the Project accordingly. In particular, we would stress that at all material times and in accordance with the contractual terms, the invariable practice in order to fulfill the contractual terms under the PSPS Practice was that the Housing Authority would have been nominating home-owners to purchase the residential units well before the development was completed.
5. It was certainly never within the contemplation of the parties, when the Tender was successfully made and the Memorandum of Agreement thereupon signed,

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that the Housing Authority at the behest of the Government would contrary to the contract act deliberately in any way to thwart, obstruct, frustrate or delay the process or progress of either the development of the Project or the sale of the units thereof. Nor was it contemplated that the Housing Authority would deliberately refrain from nominating home-owners to purchase the residential units despite the completion of the construction of the Project.

6. It was under these circumstances, and on the basis of such PSPS Practice and the contractual terms referred to herein, that our client duly commenced construction work in the beginning of 2000.

7. On 31st March 2000, our client applied for Pre-Sale Consent in accordance with the PSPS Practice.

8. Subsequently on 3rd September 2001, however, the Government's Chief Secretary for Administration ("the Chief Secretary") announced the moratorium of suspension of sales of Home Ownership Scheme ("HOS") flats, which included flats built or to be built/sold under PSPS Scheme, by the Housing Authority and Housing Society ("the Moratorium") as follows:-

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"With the permission of the Chief Executive, I have asked the Chairman, Housing Authority to implement the moratorium on all sales of HOS flats until end June 2002."

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9. In the said announcement, the Moratorium was due to be lifted on 1st July 2002, after which the sale of HOS flats was said to be not exceeding 9,000 units a year up to 2005-06, and that "radical cuts" were only to be introduced "thereafter". Thus, the Government had announced as follows:-

"We do not wish to leave a question mark over what will happen after the moratorium is lifted on 1st July 2002. By freezing HOS sales, we will inevitably build up a surplus level of flats which could be seen as a threat to the chances of market recovery. To prevent any chance of this, I have agreed with the Chairman, Housing Authority that sales of HOS flats after the moratorium will not exceed 9000 units a year up to 2005-06, subject always to the avoidance of any direct competition with the private property market. Thereafter, of course, we expect more radical cuts as a result of our long-term review."

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10. On 5th June 2002, the Chief Secretary announced and confirmed in another statement that the Moratorium would cease to apply with effect from 1st July 2002 and that, after that date, the sale of HOS/PSPS flats would resume. It was announced that two phases of HOS flats would be put on sale. The first phase of about 2,400 flats would be sold in September 2002, while the second phase of about 2,500 flats would be sold in April 2003, making a total of only 4,900 flats. This therefore represented a serious backtracking from the previous limit of not exceeding "9000 units a year up to 2005-06", and resulted in a shortfall of 4,100 units. In this statement, it was announced as follows:-

"I confirm that the moratorium will cease to apply with effect from 1 July 2002 and that, after that date, the sale of HOS flats will resume in a cautious and considered manner."

"I have decided that, for the first twelve months after the moratorium, two phases of HOS flats will be put on sale. The first phase of about 2400 flats will be sold in September this year, while the second phase of about 2500 flats will be sold in April next year, subject to the market condition. I believe this will provide a degree of certainty to the market. ... A site-specific list is attached."

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11. In the site-specific list attached to the said statement by the Chief Secretary, there were in fact 4,948 flats being covered. However, none of the 4,948 flats quota under the Phase 24A and Phase 24B sale programmes would be allocated to flats in our client's project. This means that the backtracking from the previously announced limit of "9000 units a year up to 2005-06", which resulted in a shortfall of 4,100 units, had prejudiced our client in a most direct way. This also meant that the Housing Authority was not prepared to nominate any home-owners at all to purchase the flats in the Development. The unilateral method of selection adopted in the site-specific list, however, was done entirely without regard to our client's lawful rights and was clearly most unfair to it.
12. On the other hand, during the material period, the Government (acting through the Housing Authority) had been pushing our client hard to complete the Development on time.
13. On 6th August 2002, the Occupation Permit was granted.

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14. Despite the fact that Pre-Sale Consent was applied for as early as on 31st March 2000, however, it was not until over 2 ½ years later, on 20th November 2002, that the Director of Lands granted the Pre-Sale Consent, which was some 4 months after the flats had been built.

15. On 21st November 2002, the Certificate of Compliance was granted.

16. On 28th November 2002, however, the Government through the Housing Authority backtracked again and announced in a statement inter alia as follows:-

"In agreeing to halt the production and sale of the Home Ownership Scheme (HOS) and Private Sector Participation Scheme (PSPS) flats indefinitely, ..."

"Following the decision to cease the production and sale of HOS, the Housing Department will establish a task force to work out an appropriate strategy for the disposal of the completed and other committed flats – of around 20,000 units – through market-friendly means."

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17. In December 2002, the Government through the Housing Authority backtracked even further and, in another statement, announced inter alia as follows:-

“...the Government has decided to cease the production and sale of Home Ownership Scheme flats indefinitely from 2003 onwards, except for the unsold and returned flats which would be sold to Green Form applicants.”

18. In March 2003, the Housing Authority, at the behest of the Government, has taken the ultimate plunge and terminated the PSPS Scheme altogether. Thus, in another statement, it was announced inter alia as follows:-

“On 13 November 2002, the Secretary for Housing, Planning and Lands (SHPL) delivered a Statement on Housing Policy setting out a series of measure including the measures to cease the production and sale of HOS flats indefinitely from 2003 onwards ... and to terminate the PSPS.”

19. Accordingly, the Government's termination of the PSPS Scheme, as well as your total failure to abide by the PSPS Practice and the express and implied

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contractual terms, is a breach of contract and tantamount to forcing a completely different bargain upon our client. The Government and the Housing Authority's conduct has caused extensive financial loss to our client.

20. Further, it is our client's case that in the circumstances, the Government was and has been subject to the following contractual obligations, implied as a matter of law and as a matter of necessary implication to give business efficacy to the Memorandum of Agreement :-

- (20.1) to observe and abide by the PSPS Practice and not to resile therefrom after it had been acted upon by our client to the knowledge of the Government and the Housing Authority (as had happened in this case);
- (20.2) to act reasonably and exercise reasonable endeavours to procure the Housing Authority timeously to locate and nominate suitable purchasers of the units;
- (20.3) to cooperate with and assist our client to sell the units to suitable purchasers, and to nominate promptly and without delay suitable

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purchasers to buy the units developed by our client on the faith of the PSPS Practice;

- (20.4) to refrain from causing or procuring or influencing its governmental departments or agencies to thwart, obstruct, frustrate or delay the process and progress of either the development of the Project or the sale of the units, including in particular, to refrain from causing or procuring or influencing the Director of Lands to delay or obstruct the grant of Pre-Sale Consent to our client in contravention of the PSPS Practice and beyond the ordinary course of events;

- (20.5) to refrain from such conduct as may be designated to, or would effectively result in, the thwarting, obstructing, frustrating or delaying of the process and progress of either the development of the Project or the sale of the units, whether by acting through its governmental departments or agencies, or otherwise by liaising or colluding or acting in concert with them;

- (20.6) to procure the Housing Authority:-

- (i) to take such actions on their part as were needed for the proper fulfillment of the contractual terms; and

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- (ii) not to thwart, obstruct, frustrate or delay the sale of units and the nomination of purchasers.

21. As regards the Housing Authority, the Memorandum of Agreement (and in particular the Special Conditions) imposes duties and obligations and confers rights upon the parties and certain obligations of the Government under the Memorandum of Agreement are to be discharged through the Director of Housing. By intervening in the implementation of the Memorandum of Agreement and taking upon themselves the discharge of the obligations, as well as by the receipt of the rights, in return for our client doing likewise, the Housing Authority has thereby become contractually bound by the terms of the Memorandum of Agreement (including all implied obligations arising thereunder). Further and alternatively, a collateral contract between the Housing Authority and our client upon the terms of the Memorandum of Agreement (including all implied obligations arising thereunder) had come into existence. Further, in entering into the Memorandum of Agreement which contained Conditions of Sale that purported to confer rights and impose obligations on, inter alia, both the Government and the Housing Authority, the Government acted for and on behalf of itself and the Housing Authority, and

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each was bound by the Memorandum of Agreement (including all implied obligations arising thereunder).

22. It is also our client's claim that the action described above by the Government and by the Housing Authority constitute the Tort of Procuring the Breach of the Contract we described above both with the Government and the Housing Authority. As you will be aware, the ingredients of that tortious offence are:-

(i) knowledge of an existing contract (which both parties had);

(ii) interference with it by "speaking, writing, or publishing words which communicate pressure or persuasion" to others to break the contract, or to do acts inconsistent with the contractual obligations. It is clear that the Housing Authority and the Government are in breach of this legal duty.

23. In our client's letter to the Housing Authority dated 10th June 2002, our client has already mentioned that its preliminary estimate of the losses and damages that it would suffer would amount to at least HK\$167 million per year. This includes the following:-

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- (23.1) Rates will be payable after the issuance of the Occupation Permit;
- (23.2) Our client will have to be responsible for the payment of Government rents, which would have been payable by the home-owners if the flats had been sold in accordance with the PSPS Practice;
- (23.3) There would be the loss of management fees which would have been payable by the home-owners if the flats had been sold in accordance with the PSPS Practice;
- (23.4) Huge expenses will need to be incurred for the regular maintenance of unoccupied idle flats;
- (23.5) Further huge expenses will need to be incurred for putting the unoccupied idle flats into a saleable condition after a long period of non-occupation;
- (23.6) The buildings will have aged in the meantime;
- (23.7) The withholding of sale of the flats in the Development will make it practically impossible for our client to sell or lease out the shops and

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car parking spaces in the Development, and thereby resulting in huge loss of sale proceeds and rental income for it;

(23.8) Our client will have to incur extra financial charges and additional interests due to the unexpected delay in the recovery of the capital expenditure invested by it into the Development.

24. We would also point out that our client has been exercising its best endeavours in the past 11 months to try to resolve the matter amicably but in vain. Since no constructive response has been made, legal advices have therefore been sought from 2 very experienced Senior Counsel, both of whom confirmed the validity of our client's intended claims against the Government. Whilst this letter is intended to serve as our client's final attempt to open discussions leading to an amicable settlement, Senior Counsel and Counsel are at present working on drafting a Statement of Claim. In the circumstances, we have instructions, depending upon your response to this letter, to commence proceedings against you if necessary.

Yours faithfully,

Cheung, Chan & Chung