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P.0732

PRIME MINISTER

Fixed Cross-Channel Link

(E(82)40 and 41)

INTRODUCTION

At the Anglo-French Summit held on 10 and 11 September 1981 the two Transport Ministers agreed that there should be a "joint study by experts of the type and scope of possible fixed links, taking account of the interests of maritime transport, with a view to advising both Governments on whether a scheme for a fixed cross-channel link can be developed which would be acceptable to and in the interests of both countries". This work has now been completed and is summarised in Annex A to the Secretary of State for Transport's paper, E(82)40. The Secretary of State now seeks three decisions, namely:

- a. a decision in principle in favour of a twin tunnel, subject to the satisfactory negotiation of financial and organisation arrangements with the French and the institutions on the lines described in his paper;
 - b. that the Government should offer the prospect to the institutions concerned of a guarantee against political cancellation, subject to satisfactory detailed definition of this, but not any form of "performance" guarantee; and
 - c. that drafts should be prepared of a public announcement and of a White Paper, and circulated for agreement in correspondence.
2. The CPRS in their paper, E(82)41, raise the question of whether the Government will need to retain the right to regulate tariffs and point out that, if so, the project may be less attractive to the private sector. They also argue that if the bi-national company fails there will be pressure to complete the tunnel as a public sector project.

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MAIN ISSUES

3. The main issues are as follows:

i. Should the proposal for a fixed link go ahead?

This depends mainly on:

- a. the economic case
- b. environmental considerations
- c. whether the current proposal satisfies the Government's requirements for private sector involvement.

ii. If Ministers decide that the proposal should not go ahead, how are relations with the French best handled?

iii. If Ministers decide in favour of the proposal, should the link be a twin rail tunnel or some other option?

The economic case

4. In a submission to the Joint Study Group the Dover Harbour Board and the cross-channel ferry operators argued that shipping services have the potential to carry all foreseeable traffic and to do so at substantially lower cost than at present. The Joint Study Group accepts that even on the basis of more pessimistic assumptions than those put forward by the Dover Harbour Board and the ferry operators, shipping services could undoubtedly handle future traffic. There is, therefore, no objective need for a fixed link in terms of an excess of demand over capacity. But the Joint Study Report argues that a fixed link could offer advantages in terms of the diversity of service offered and the facilitation of trade and other exchanges with the rest of Europe.

5. The economic case is assessed in Annex D to E(82)40. The Treasury take the view that the economic case for proceeding with a fixed cross-channel link has not been proven, and this seems to be the case. The internal rates of return range from 0 per cent to nearly 14 per cent depending on the type of fixed link and on the combination of assumptions chosen. Even taking the most realistic assumption (Scenario B), the rates of return are all so close to the 7 per cent Test Discount Rate and, as the more detailed material circulated to Departments at official level

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demonstrates, are so sensitive to changes in key assumptions such as traffic forecasts and construction times and costs, that further, more detailed economic analysis would be inevitable if this were a project to be financed from public expenditure.

Environmental considerations

6. The environmental impact in the UK of a fixed cross-channel link can only be evaluated in detail once a specific design has been drawn up. But whichever design is chosen it is bound to have an impact, particularly on the Kent coast, large stretches of which are designated as being of outstanding natural beauty and parts of which are also designated as sites of significant scientific interest. There is, therefore, bound to be pressure from environmentalists, as there was in the case of the previous channel tunnel, against the link; and the fact that the need for a link is far from conclusive will significantly strengthen their case. The row over heavy goods vehicles demonstrated that the environmental lobby has some sympathy in Parliament. Ministers will therefore need to consider carefully the likely strength of this in the case of a channel link and whether it could be successfully overcome.

Private sector involvement

7. It is therefore clear that if the fixed channel link was to be a public sector project the case for going ahead with it would be marginal. If however it was to be a private sector project, the economic case could be left to be tested by the market. The Government has therefore consistently taken the view that the UK's share of the cost must be met by the private sector on the basis of a genuine risk and without any form of commercial guarantee by the Government, although the Government has agreed to consider a guarantee against "political cancellation". The Secretary of State says in paragraph 15 of E(82)40 that both he and his French counterpart have had strong, if qualified, expressions of interest in a fixed channel link from major British and French financial institutions. The feasibility of the proposal as a private sector project must depend crucially on the basis for setting it up. Ministers will need to probe carefully whether the current proposal for a bi-national company meets the Government's requirements for genuine private sector involvement.




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8. The proposal for a bi-national company is set out in Annex E to E(82)40. The company would be owned by a variety of shareholders dispersed in France and the UK so that it would be impossible in practice to identify a "UK half" which could be blamed for any failure of the project. There would be two classes of shareholder: "financial shareholders" who would provide the equity and would have 75 per cent of the votes of the company; and "Community shareholders" who would include, for example, the French and UK railways, local authorities on both sides of the Channel and possibly the Dover Harbour Board, who would have no direct financial interest in the company but might have 25 per cent of the votes and possibly some representation on its Board.

9. The company would be created by legislation in each country and would have a statutory duty, enforceable in each country to construct and operate the channel link. This duty could only be rescinded by agreement between the two Governments. A Treaty between the two Governments would set out the arrangements required for the dissolution of the company either at the end of the concession over the fixed link, or if the company failed to meet its obligations. Annex E to the Secretary of State's paper acknowledges that special arrangements will be required for accounts, for audit and for taxation and also to provide for arbitration in the event of disputes between the two countries and the Company or the Company and its shareholders over the application or interpretation of the Treaty etc, but gives no indication of what these might be. The French Government have apparently accepted that a company along these lines might meet their requirements and the financial institutions have indicated that the proposal seems technically feasible.

10. The Treasury takes the view that the project as presently conceived is determined by the market more in theory than in practice. The objectives of the bi-national company which the Secretary of State proposes should be established to construct the fixed link would effectively be determined by the two Governments. The proposal is that the company will be under a statutory duty to construct the link to a predetermined design and to operate it. The present intention is that the shareholders in the company will be chosen by the two Governments. Finally, the Treasury takes the view that it would probably be possible for the company to borrow the 60 per cent or so of the construction costs of the link only if the British and French railways were to offer guarantees about the level of future revenue; such guarantees would inevitably be regarded as backed by the two Governments.

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11. Ministers will also need to bear in mind the two points raised by the CPRS in E(82)41 - the extent to which tariffs for the tunnel may need to be regulated, thus making the project less attractive to the private sector, and the probability that if private sector interests pulled out the two Governments would find it difficult to resist pressures to complete and run the tunnel as a public sector operation.

12. Finally as the Secretary of State for Transport recognises in paragraph 19 of his paper there would remain the need for a guarantee against political cancellation and the definition of such a guarantee would require the most careful consideration.

13. A great deal more work would in any case be needed on the bi-national company proposal. Ministers may however be doubtful, even at this stage, whether the concept as outlined would meet their requirements for private sector involvement. It is important that if Ministers decide to test the views of the market, the institutional arrangements should be fully spelt out so that private sector reactions are genuinely tested. Moreover Ministers would need to be clear from the outset that any institutional arrangements which were put forward experimentally did provide adequately for genuine private sector risk-taking. It would be more difficult to reject proposals on these grounds at a later stage.

Relations with the French

14. Internationally the case for proceeding with the link rests primarily on the importance which the French Government appears to attach to it. The UK accordingly has an interest in not antagonising them on this subject particularly at a time when we need their support on the Falklands and their agreement to a deal on the 30 May Mandate. A decision on our part against would reinforce the doubts they have about our value as a partner and could affect in particular their attitude in the Mandate negotiation. The Foreign Secretary will wish to assess this risk and the implications in particular for a budget settlement. If Ministers decide that the project is not worth proceeding with, both the presentation of that decision to the French Government and its timing will be important.

15. There are three main options. We might tell the French straight away that we do not wish to proceed; but this would needlessly antagonise them at what may be

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a critical juncture in the budget negotiation and while we still need their support over the Falklands. Or we might allow the project to proceed to the next step, which is testing the reactions of the market, and then if those are unfavourable blame cancellation on that, meanwhile saying nothing of our doubts to the French. Or we might make clear to them now our reservations about proceeding with a project for which the economic case is so inconclusive while expressing willingness if the French wish for the reactions of the market to be tested before any final decision is taken. The Foreign Secretary is likely to favour the last option. If this option were to be adopted the points made in paragraph 13 above about testing the market on a clear and satisfactory basis would need to be taken into account.

Twin tunnel or other option

16. The Joint Study Group investigated a wide range of possible links - a suspension bridge, an immersed tube, a combined bridge/tube scheme and a variety of tunnels. You will be aware of Mr Ian MacGregor's advocacy of the "Euroroute" proposals for a road/rail option about which the Secretary of State for Wales expressed interest in his letter to the Secretary of State for Transport of 19 April. The Secretary of State for Transport recommends twin seven metre railway tunnels which could carry both conventional rail traffic and also roll on roll off (RO-RO) vehicle traffic.

17. Only the tunnel relies on largely-proven technology; the others all raise major technical and design difficulties which in some cases would take perhaps three years to overcome before the final decision to proceed could be taken. Moreover, the cost of the Secretary of State's preferred option is roughly half that of the others (£2 billion against £4-5 billion). Twin railway tunnels are estimated to be likely to attract roughly half of the traffic from the ferry services, whereas the smaller tunnel options would attract no more than perhaps 20 per cent and the other types of link would attract 60-80 per cent, which would probably effectively eliminate the ferry services. The French Government is also opposed to a "drive through" link because of the impact this would have on employment in the politically-sensitive area of the Pas de Calais.

18. The balance of argument therefore seems to point firmly towards a rail tunnel. The Secretary of State's preference for a seven metre tunnel is based on the fact



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that this would allow RO-RO traffic to be carried and therefore in his view undermine the monopoly power of BR and of the railway trade unions over this service. The availability of RO-RO services would certainly be likely greatly to increase the attractiveness of the tunnel and is probably vital to its success. But the argument about monopoly power seems unconvincing, since the vehicles will be carried on trains driven, presumably, by ASLEF members and their French counterparts. The provision of twin tunnels would greatly increase the flexibility of the cross-channel services and therefore their attractiveness, at the expense of increasing the cost by between £0.5 and 1 billion over the cost of alternative seven metre single tunnel links. It would be possible to construct a twin tunnel in two stages with only very modest increases in resource costs. Doing so would also give both Governments the opportunity to cancel the construction of a second tunnel if, in the event, the expected growth in traffic did not materialise. The Secretary of State for Transport does not explain in his paper why the option of proceeding in this way appears to have been ruled out by him.

HANDLING

19. You will want to invite the Secretary of State for Transport and Mr Sparrow to introduce their respective papers. You might focus the discussion initially on the main policy issues of whether a fixed link is desirable on economic and other grounds and whether the current proposal meets the essential requirements for private sector involvement. The Chief Secretary, Treasury and the Secretary of State for Trade in particular will wish to contribute to this part of the discussion.

20. If the decision is against going ahead you will want to move on to relations with the French and to seek comments particularly from the Foreign and Commonwealth Secretary.

21. If the decision is in favour of going ahead, there might then be some detailed discussion of the twin tunnel as against other options. You will want the Secretary of State for Transport to amplify the proposals in his paper and to comment on the option of building the twin tunnel in two stages.



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CONCLUSIONS

22. You will wish to reach conclusions on the following points:

- i. whether a fixed channel link is desirable;
- ii. whether the current proposal for a bi-national company meets the requirements for genuine private sector involvement;
- iii. depending on the decisions on i. and ii. and bearing in mind the importance of relations with the French, whether the next step should be:
 - a. to abandon the project now, or
 - b. to test private sector support for the project and, if so, on what basis.
- iv. whether in particular the Secretary of State for Transport should be authorised to offer the prospect of a guarantee against political cancellation or whether more work is needed to clarify the definition of such a guarantee before it is offered;
- v. whether the form of link should be a twin railway tunnel and if so, whether it should be constructed in one or more phases.
- vi. depending on earlier decisions, whether the Secretary of State for Transport should be invited to circulate drafts of a public announcement and a White Paper or whether more work is needed before that stage and, if so, on what specific matters.

PLG

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