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P.01505

PRIME MINISTER

A Channel Fixed Link: Guidelines for Promoters.

E(A) (85) 11.

BACKGROUND

You agreed with President Mitterrand at the Anglo/French Summit on 29 November that the working group established by Transport Ministers to work out guidelines for promoters of a cross channel link should submit their report to Ministers by the end of February. Their report, in the form of draft guidelines for promoters, together with a report by UK officials involved in the negotiations are attached to the note by the Secretary of State for Transport. Once agreed these guidelines will be published probably by the end of March. The negotiations have been carried on in an excellent atmosphere, and it would seem sensible to avoid pressing UK views on points in the guidelines where there has not been complete agreement unless it is clear that this is necessary to safeguard an important UK interest. Bids will be called for from the promoters within the next six months (to be finally agreed) and the choice will then be made by the two Governments. As the guidelines make clear, once a scheme is chosen, a hybrid Bill would be presented to Parliament incorporating an Anglo/French Treaty and the necessary domestic legislation, and on ratification of the Treaty Agreements would be signed with the chosen promoters. There are no undertakings whatsoever by Governments other than 'best endeavours' until the legislation enters into force.

MAIN ISSUES

2. Negotiation of the Guidelines has thrown up a number of important issues on which Ministerial decisions are required. These are outlined in the note by the Secretary of State for



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Competition Policy: (Mr Ridley para 3, Officials paras 6-8, Guideline 1.3)

3. The implications of allowing market freedom - within European and national competition law - to the promoters of the link are that the ferries will have to compete in order to survive. This could lead to considerable dependence, both economic and strategic, on the link itself if the short sea crossing ferries go out of business. With the qualified exception of Mr Lawson, Ministerial correspondence on this subject so far (there have also been letters from Mr Tebbit, Mr Heseltine, Sir Geoffrey Howe, Lord Gowrie and Mr Jenkin) is generally opposed to interfering with the market to assist the ferries. Mr Ridley however would like the guidelines to contain a specific reference to the possibility of Government intervention to preserve the ferries; in that event more detailed guidance would be needed for promoters regarding the level of ferry services which must be maintained. There could be awkward legal implications.

Company organisation: (Mr Ridley para 4, Officials para 9, Guideline 3.2(b))

4. Mr Ridley would be prepared to concede to the French insistence on a strict 50/50 sharing of costs and revenue. Mr Tebbit would prefer a looser formulation such as 'broad equivalence'. This however is unacceptable to the French.

On frontier controls: (Mr Ridley para 5, Officials para 12, Guideline 2.3).

5. The French would like to keep open the possibility of placing both French and British controls at one end of the Link in order to simplify procedures. Mr Jopling cannot agree for animal health reasons. The French would be prepared to accept a guideline which invited promoters to make suggestions for frontier arrangements.

Duty-free facilities: (Mr Ridley para 6, Officials para 13, Guideline 3.6)

6. The French would like these abolished on ferries; failing that they believe they should be provided for on the Link on grounds of equity. We see difficulties in both approaches. The French would accept a guideline which tells promoters not to assume that there would be duty free facilities, and which would



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would require promoters to provide cash flow forecasts both with and without them. Ministers are simply asked to endorse this approach at this stage.

Community Finance: (Mr Ridley para 7, Officials para 16)

7. Last November the French agreed, reluctantly, that there should be no EC finance available for the project. But they are not prepared to see the guidelines explicitly rule out all possibility of EC finance in the future, and say that such a provision would mean rejection of the guidelines by French Ministers. Rather than relying on our position being made public at a later stage, Mr Ridley believes the guidelines should be explicit now. There is a case for remaining silent and keeping long-term options open.

Rail infrastructure: (Mr Ridley para 8, Officials para 17 Guideline 1:4.2)

8. Officials have negotiated a firm text regarding the restrictions on BR's involvement. It leaves implicit the fact that the promoters will almost certainly have to invest in rail infrastructure in the UK (which they will not have to for road infrastructure). The French have accepted the text with difficulty and have made clear that re-opening this issue will be taken very badly and will confirm their suspicions that we are biased against a rail link. Ministers may be asked to express their views on whether the text is consistent with the Government's policy on investment by British Rail. Mr Ridley believes the text should be re-opened to make explicit the requirement that the promoters should finance investment which does not meet the Government's criteria for investment by BR.

The legislative and consultative procedures: (Mr Ridley para 9, Officials para 21, Guideline 1.2).

9. These do not envisage a public enquiry on the UK side. Mr Ridley's view is that this would spell the end of the project because of the delays involved. He suggests instead local consultations with the final decisions being taken by Parliament. Ministers will need to consider whether this procedure would be sustainable, given the enormous impact the Link could have on the economy of the Channel ports.



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VAT: (Officials para 15, guideline 3.5)

10. It is an agreed objective that promoters should somehow be relieved of net payments during construction. The officials' paper recommends that we should continue to try to persuade the French that the Link should be treated like the UK ferries and zero rated.

~~_____~~

Political guarantees (Officials para 18, guideline 1.1)

11. Political guarantees are limited to undertakings by Governments not to terminate the concession, once agreements are signed between Governments, other than for reasons of national defence and security or non-adherence to the terms of the concession. Changes in the law are expressly excluded. Breach would, however, give rise to a prima facie claim for compensation. Ministers will need to consider whether this provision is sufficiently restrictive.

The territorial 'Gap': (para 20 of the Officials paper).

12. This is not an issue for decision. Ministers are merely asked to note that there is a problem and that we intend to clarify in the Bill UK rights between the present 3 mile territorial waters limit and the median line.

On Eurobridge: (Mr Ridley, para 10)

13. The evidence so far suggests that this is not a runner both on technical grounds - although it could be a desirable stimulus to the improvement of materials technology, the size of the proposed spans would be four times larger than anything yet constructed - and on navigational grounds because of the interference with the main shipping lanes. Mr Ridley proposes informing Eurobridge in order to save them from wasting any more money.

But see
in Robin
N. Chelms
note

NEXT STEPS

14. There is to be a final meeting of UK and French officials on 27/28 February at which the British Government's views on the draft guidelines will be conveyed to the French. Unless



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there is complete agreement on that occasion, a meeting between Ministers of Transport will need to be arranged.

HANDLING

15. The Secretary of State for Transport will wish to speak to the officials' report, and make his case on the issues he proposes for further negotiation with his French counterpart. The other Ministers concerned with each of the issues listed in paragraph 2 above will wish to register any specific points they may have (it may be useful to take these issues seriatim) and to indicate their views on the three particular issues raised by Mr Ridley.

CONCLUSIONS

16. You will wish to reach conclusions on the following:

(i) the position to be taken on each of the issues listed in paragraph 2 above;

(ii) the remit to be given to officials for their meeting with the French on 27 February 1985.

PLG

P L GREGSON
Cabinet Office
22 February 1985

An annex providing
a guided tour of the
document is attached.
No need to look beyond p. 36

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except for final
annex.

22 February 1985

AT 22/2

CROSS CHANNEL LINK

Some forecasters see a Europe, comfortable and set in its ways, falling steadily further behind a confident and dynamic North America, and the bustling innovative economies around the Pacific, notably Japan. That is not a vision you share, nor do the French.

In this context, the Link offers more than the prospect of a cheaper and more efficient means of crossing the Channel. Potentially, it can symbolise a new-found confidence and spirit of enterprise within Europe - an eye-catching demonstration of what can be achieved by the private sector when Governments create a favourable commercial climate. Promoters are shaping up to answer that challenge.

In contrast to this positive frame of mind, there is a negative one which sees more pitfalls than opportunities - hence, as it were, the need for a man to walk in front of a train waving a red flag. The loss of our insularity is seen as threatening. Rabid dogs and terrorist attacks on the Link are given as much weight as the benefits to millions of users and British trade. This frame of mind worries about the demise of the ferries and the consequent threat to economic and military security (not apparently shared by the MoD). It fears the abuse of monopoly power and anti-competitive behaviour, and contemplates tariff regulation and the possible need for special taxes or levies. It expects the promoter to

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take all the technical and commercial risks, but feels
uncomfortable about allowing him the possibility, if
successful, of high reward.

Where the
are alternative
texts, the
French version
is more free
market

Ironically, the French team are embracing the positive
spirit of the Thatcherite private enterprise formula for
construction and operation of the Link, with more inspiration
and enthusiasm than the British. The British officials, loyal
to their narrow departmental mandates, tend to reflect the
nervous negative frame of mind. So it would seem do some of
your colleagues, including Nicholas Ridley.

How the few outstanding issues are resolved in E(A) will
determine whether the guidelines for the promoters are
conducive to a positive private enterprise response.

The central issue concerns competition policy, and the
related question of whether market forces should be left
unchecked if the Link were to threaten the demise of ferry
traffic across the Straits of Dover. The French favour a free
market philosophy and argue that if the promoters are to take
all the commercial and technical risks without Government
guarantees, they should be free to market the Link and set
tariffs, subject only to the general laws governing
competition and the abuse of monopoly power. The British are
ambivalent. There is a body of opinion, led by Nicholas
Ridley and partially supported by the Chancellor, which argues
that however efficient and beneficial the Link may be, it
should not ultimately be allowed to drive the Straits of Dover

ferries out of business; to do so would be a threat to economic and military security.

The concern is valid, but artificially holding up tariffs on the Link, so as to preserve inefficient ferries, is not a cost-effective form of insurance. Michael Heseltine says that we need to wait until the time to decide what measures are appropriate. He is right. So is Norman Tebbit in wanting the cross-Channel transportation market to be a free one, subject only to general competition law.

The other key points raised by Nicholas Ridley are:

1. French insistence that 50% of the venture should be undertaken by a corporate entity resident in France and 50% by an entity resident in the UK. What they are really saying is that we cannot allow the promoters free rein to create the most tax-effective corporate structure; politically, it would be unacceptable to one country or the other if they did not have access to 50% of the taxable revenue and the associated contributions to GNP and capital formation. The French are right.
2. Frontier formalities. There is a danger that our hang-ups over rabies, plant health and terrorists will lead to unnecessarily tight time-consuming controls to the detriment of users. The guidelines should indicate that the frontier formalities will be confined to the

essential, and arrangements should be devised to minimise delays to users.

3. Duty free. As proposed, this question can be left open until the promoters have demonstrated its significance to the commercial viability of their schemes. In principle, both the French and British sides are right in wanting to reduce, rather than increase, the scope of duty free facilities across international borders. However, it would be wrong to penalise the Link in competition with the ferries.

4. Community finance. There must be no fudging the principle of no Government money or financial guarantees. The French accept this for the Link, but do not want to veto all possibility of community funding, perhaps because they hope to obtain community funds for some of the associated infrastructure investment. Nicholas Ridley should explore the subject with his French counterpart but he is right to be suspicious; there is no Community money, only European taxpayers' contributions.

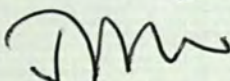
5. Rail infrastructure. Although this has been a sensitive subject with the French, the Working Party has hammered out a satisfactory guideline, which makes clear that neither BR nor SNCF will be permitted to undertake additional investment for the rail infrastructure associated with the Link, unless that investment meets their normal commercial criteria and the established

their normal commercial criteria and the established rules governing the respective public sector expenditure.

Nicholas Ridley wants to go further than this, in explicitly stating that any additional rail infrastructure investment which does not satisfy this criterion will have to be funded by the promoters. But why should a private sector undertaking, working on a commercial basis, be prepared to undertake additional investment for less than public utility rates of return? If it is not possible to conclude a tariff for rail usage which provides the state railways with a satisfactory return on their infrastructure investment, then there should be no rail element of the Link. The guideline can stand as it is. We should not imply that the Governments expect road to cross-subsidise rail.

Finally, you might like to suggest that the while officials have done a commendable job in formulating the substance of the guidelines for promoters, the current raw draft would benefit from re-editing to achieve greater clarity and to convey a positive encouraging tone.

The attached Annex may help you to form a quick impression of the guidelines.



JOHN WYBREW

ANNEXTHE GUIDELINES - SIGNPOSTS TO THE KEY PASSAGES

Much of the document covers the technical and operational details which promoters will have to provide. For the rest, there is a good deal of overlap between the product of four separate drafting teams. The square brackets indicate issues unresolved pending advice from Ministers.

On page 8 (and frequently thereafter) the principle of no Government funding or financial guarantees is stated. Further down, the confined nature of the political guarantee is spelt out:

"The Governments undertake not to terminate the promoters' right to construct or operate a Link, provided the terms of the concession are adhered to, other than for reasons of defence or national security."

Breach of this undertaking would entitle promoters to financial compensation. Unless that breach is clearly the responsibility of one government or the other, the allocation of the compensation payments between the governments will be decided by arbitration or on the basis of international law.

The first paragraph of the section on Competition and Market Freedom (page 12) sets out the principle that since the promoters are required to take all the technical and

commercial risks in constructing and operating the Link, they should enjoy the freedom to decide their own commercial policy, the tariffs to be charged and the level of service to be offered. They are also told that it is their business whether they provide a rail element in the Link on terms to be agreed with the state railways.

The square brackets around the middle of page 13 cover the crucial question of whether the Governments will seek to interfere with the free competition between the Link and other means of cross-Channel transport, other than through the normal laws of competition. The British text includes the offputting warning, "the Governments may wish to review the implications in the public interest of any situation in which the Link appeared to be about to achieve a monopoly position".

The section on Infrastructure further down page 13 was particularly difficult to negotiate with the French. Promoters are expected to pay only for the limited road infrastructure required exclusively for access to the Link. The tightly-drawn conditions for the associated rail infrastructure undertaken by the state railways are set out on page 14.

Page 15 covers the liability of promoters to maintain adequate insurance cover and to clear away any abandoned obstructions to navigation in the Channel.

The description of the legal regime, beginning on page 16, is a carefully worded tiptoe through the minefield of international law and related principles. It does not raise any contentious policy issues. However, you might note (page 16) that the promoters are explicitly directed "not to discriminate in the awarding of sub-contracts and in their procurement contracts against the nationals of other EC member states on grounds of nationality". One wonders why we should not include the principles of "full and fair opportunity" for British and French suppliers and contractors along the lines of the understandings covering North Sea oil and gas development. A quick skim over pages 17 to 20 will give you the essence of the legal framework.

The general principles of the guidelines covering finance and taxation (page 24) are worth a glance, although they are basically a repetition of earlier material.

The paragraph flagged near the top of page 25 embodies the British preference for arrangements to ensure that the amount subject to tax in the two countries is "broadly equivalent". This compares with the provisions flagged on page 27 which incorporate the French requirement for an equal sharing of costs and receipts leading on to an equal division of taxable revenue between the two Governments.

Other points worth noting in this area of the guidelines are:

- the Governments' preference for a single project management organisation to achieve maximum efficiency;
- the invitation to promoters to make proposals on the duration of the concession;
- the obligation to maintain the Link in good condition until the end of the concession when it reverts to full ownership by the two Governments.

On page 30, promoters are advised that the Governments will expect a substantial proportion of equity risk capital in the overall funding of the venture.

Page 34 touches on the unresolved question of how to justify VAT exemption for the construction of the Link to the EEC. The issues are technical.

The contentious question of the availability of duty free facilities is covered on page 36.

The rest of the guidelines deals with technical and operational details.

The final section provides a comparison between Channel Tunnel Group, Euro-Route, and Eurobridge.



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PRIME MINISTER

CHANNEL FIXED LINK

E(A) is being asked by the Secretary of State for Transport to decide on several policy issues concerning the proposed Channel Fixed Link prior to publication of the guidelines for promoters.

2. The Secretary of State is proposing that no further consideration should be given to the option of a road bridge of advanced design (the "Eurobridge"). The reasons given are navigation difficulties and the problems of including suspension spans in new materials some four times longer than any yet built.

3. In the three years during which I have kept in touch with this project, the Department of Transport has shown a consistent bias against 'bridge' as opposed to 'tunnel' solutions to the extent that it is only recently that they have grudgingly accepted the viability of the bridge/tunnel hybrid "Euro-route" solution.

4. I am far from convinced that the Eurobridge is technically non-feasible and I see considerable dangers in Government foreclosing certain technical options on the basis of second-guessing by officials. Bridge engineering is a field where there are important opportunities for overseas contracts. Development work on new materials could place United Kingdom civil engineering companies in an advantageous position over the next few decades.

5. My advice is that no option for the Channel Fixed Link should be abandoned at this stage on technical grounds although it is reasonable to warn of the navigation problems. Promoters should be given the opportunity to make the

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economic navigational and technical cases for each of the options. If Department of Transport officials are proved correct, and formidable technical and navigational problems remain with the Eurobridge option, then it will die a natural death.

6. I am copying this minute to Sir Robert Armstrong.

RBN .

ROBIN NICHOLSON

22 February 1985

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