

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

15 February 1985

The Rt Hon Nicholas Ridley MP  
Secretary of State for Transport  
Department of Transport  
2 Marsham Street  
LONDON SW1

*John Nick*

CHANNEL FIXED LINK (CFL)

Thank you for your letter of 12 February.

I agree with you about the length of concession to the promoters; duty-free facilities; and taxation issues.

I agree that we should avoid constructing special rules, either helpful to or against the CFL project. But a CFL will be more than an internationally financed construction project, with a dominant position. We would also be awarding a monopoly concession with major economic and defence implications. So we need to see that it is run in the public as well as the promoters' interest, and that we can lay down conditions (or intervene if necessary) for that reason.

I agree that we should maintain robust communications on the short sea links. For economic as well as defence reasons we must avoid becoming unnecessarily dependent on one link. It would invite industrial action or terrorism. But we cannot be too black and white about preserving the ferries. When a CFL is operating, governments will have to consider the trade off between the value of robust and flexible communications, and the cost of being too soft on the ferries. The balance may shift, and cannot be predicted. There needs to be a statement in the guidelines of the public interest and right of governments to defend that interest. I should also like to see a statement that a link will be free to price its services in competition so long as it does not threaten to infringe public interest. The form of words at the end of the note you enclosed covers the case pretty well. Promoters will not be surprised by it. They will no doubt also want to know what sort of regime might eventually apply. We can consider that when we know which particular form of link we are dealing with.

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CONFIDENTIAL



I accept that we should consider investment by British Rail, not for construction of the link itself, but for related improvements, if it meets our required rate of return. But this must not increase public expenditure. The guidelines need to be clear on this, as attached.

Our policy that no public money should be involved in the construction of a link also means that BR must not pay for use of rail facilities on terms which amount to financing the capital costs. Problems might arise in particular if a road-based scheme had to include a rail tunnel as well to satisfy the French. If BR effectively leases an asset then the capital cost would normally count as public expenditure. The point is covered by the attached guideline, but we need to make clear to BR that this will be our interpretation before they enter into any negotiations with promoters. Similar considerations could apply if EuroRoute were to hand over a completed tunnel to BR ownership (cross-subsidising from their profits on the road-link).

On roads, we had better see what promoters say their schemes will involve before we consider any commitments.

You mention the possibility of introducing a special tax or levy "in the later years of a long or indefinite concession". I understand the point. It is a basic principle of taxation that we may introduce whatever tax we judge proper and can defend to Parliament at any stage. That is a fact of commercial life, and we cannot hand out exemptions. The point will presumably be made in the guidelines.

The French views on company structure bear on other important issues besides tax. I look forward to seeing what you propose about ownership and control. My initial instinct is not to proceed - as the French seem to want - by restrictions on the nationality of shareholders. Even if it were possible under EC law, that could unduly restrict financing. But we need to consider specific reserved rights of control in the nature of a "golden share".

I am sending copies of this letter to the Prime Minister, to other members of E(A), to the Foreign Secretary and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read "Nigel Lawson".

NIGEL LAWSON



Channel Tunnel : TRANSPORT AIR

15 FEB 1993



DRAFT GUIDELINES ON RAIL

There will be no Government grant or subsidy to BR for infrastructure or rolling stock investment or for the operation of through services.

2. Any BR capital expenditure will have to be on a strictly commercial basis, applying the tests already applied to BR's optional investment, and consistent with Government policies on public expenditure.

3. Any rail investment which does not meet BR's usual tests will have to be financed by the promoters.

The attached 'Draft Guidelines on Rail' should have been attached to the Chancellor's letter to Nicholas Ridley dated 15 February on Channel Fixed Link.

Apologies for any inconvenience caused.

ABlop

Chancellor's Office

18/2/85





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20/2  
CNO

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000  
DIRECT DIALLING 01-218 2111/3

MO 21/8/5

19th February 1985

*De Nil*

CHANNEL FIXED LINK

In your letter of 12th February to Nigel Lawson, you sought colleagues' views on several aspects of the current position on the promoters' guidelines for a Channel Fixed Link (CFL). I am sorry not to have replied before now but you will appreciate that other concerns have intervened.

I have not had an opportunity to consider in detail the paper prepared by officials. However, my major concern, which I have mentioned to you on previous occasions, relates to the manner in which the proposed CFL might be funded. I simply do not believe that it will be possible for this project to be a success, if it has to rely solely on private funds.

There is also, of course, a defence interest in the CFL proposal, as Geoffrey Howe pointed out in his letter of 15th February, in that it would have implications for cross-channel and other ferry services. Our present plans for the reinforcement of Europe depend upon using a large number of the ferries now operating. However, there may be alternatives which we can consider if those ferries look likely to disappear. These could include assistance from our allies, alternative modes of operation or possible mothballing.

The Rt Hon Nicholas Ridley MP





ships. I would not suggest at this stage that, whatever the cost, the ferries must be kept operating in order to meet our defence needs.

Against this background I support your proposed line, of inviting promoters themselves to suggest how the ferries can be kept in operation. I would be grateful to be kept fully informed on developments on this front, and for the MOD to be involved in assessing the promoters' proposals.

I am copying this letter to the Prime Minister and other members of E(A), and to Sir Robert Armstrong.

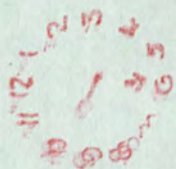
A handwritten signature in dark ink, appearing to read "Michael Heseltine". The signature is written in a cursive style with a prominent initial "M".

Michael Heseltine



Transpot: Channel Tunnel Pt 2

20 FEB 1985







u D/O  
DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB

Richard Mottram Esq  
Private Secretary to  
the Secretary of State for Defence  
Ministry of Defence  
Main Building  
Whitehall  
LONDON  
SW1A 2HB

W 14h  
13 February 1985

Dear Richard

CHANNEL FIXED LINK

The attached letter of 12 February from my Secretary of State to the Chancellor should have been copied to your Secretary of State as well as to the Prime Minister, members of E(A) and the Foreign Secretary. It was not and I apologise for that.

As a reminder that future correspondence on this subject should be copied to your Secretary of State as well I am sending a copy of this letter to Tim Flesher at No.10, Peter Ricketts in the Foreign Secretary's office, to the Private Secretaries of members of E(A) and to Richard Hatfield.

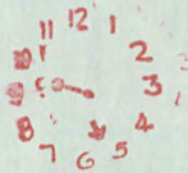
yours sincerely,

Henry Derwent

H C S DERWENT  
Private Secretary



14 FEB 1985





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CABINET OFFICE

AT  
From the Chancellor of the  
Duchy of Lancaster  
Lord Gowrie

NBM  
AT 20/2  
MANAGEMENT AND PERSONNEL OFFICE  
Great George Street  
London SW1P 3AL  
Telephone 01-233 8610

The Rt Hon Nicholas Ridley MP  
Secretary of State for Transport  
Department of Transport  
2 Marsham Street  
London SW1

18 February 1985

*Dear Nicholas,*

CHANNEL FIXED LINK (CFL)

Thank you for your letter of 12 February. I have now also seen the replies from Nigel Lawson and Geoffrey Howe.

While I appreciate that negotiations must continue at official level right up to 25 February, I think it would be quite wrong for discussion in E(A) to be unduly constrained by any positions taken up by officials between now and then. It will after all be an enormous and unique project with major implications for our (and Europe's) economic and social life, and the issues raised in your paper warrant more mature consideration and discussion than is possible in a brief round of correspondence.

The main marker which I would like to put down at this stage is that I think we do need to be careful to avoid being side-tracked by the inevitably complex and important contractual issues into losing sight of the wider significance of the project. The more conditions we lay down at the start, the less ambitious and therefore potentially less worthwhile the proposals put forward by the promoters will be. I am very uneasy about the idea of conditions designed specifically to preserve the ferries. I am not convinced that the public interest requires their preservation and in particular would have thought that our defence requirements could be met by other means. I am also concerned that we should not be so transfixed by the current problems of frontier controls as to forget that it ought to be our objective in this, as in other areas of Community relations, to be seeking to remove obstacles to the free movement of goods and persons. Indeed,

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if we are not prepared to take action to ensure free movement at either end of the Link, I seriously question whether the whole enterprise is worthwhile.

Finally, I am a little puzzled by the line proposed on BR investment. As paras 20-24 of the note by your officials make clear, it would be logical and consistent with current principles to allow BR to borrow to finance CFL-related investment which met the normal tests of viability. To forbid this would be both inconsistent with normal practice and, in addition, could well be a major discouragement to the promoters. While such borrowing might add to our PE planning total in the survey period, it need not do so if it is offset by savings elsewhere or is met from the Reserve. But since the main spending is likely to come after 1986/7 anyway, we should surely judge any such proposal from BR on its merits rather than rule it out now for years which have not yet even entered the PES.

I hope we shall be able to explore these and other issues more fully on 25 February. Meanwhile I am sending copies of this letter to the Prime Minister, to other members of E(A), the Foreign Secretary, the Secretary of State for Defence and to Sir Robert Armstrong.

Y  
Lons,  
epm  
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GOWRIE

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DEPARTMENT OF TRADE AND INDUSTRY  
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Secretary of State for Trade and Industry

18 February 1985

The Rt Hon Nicholas Ridley MP  
Secretary of State for Transport  
Department of Transport  
2 Marsham Street  
LONDON  
SW1P 3EP

D Nicholas

CHANNEL FIXED LINK

Thank you for copying to me your letter of 12 February to the Chancellor on the Channel Fixed Link (CFL).

2 I agree that in principle we should avoid constructing special rules for the project. Any attempt to protect the ferries - or Government - from a change in the economics of traffic movements between the UK and the continent would be a fundamental departure from this principle. This is my main concern. I very much doubt either the wisdom or the practicability of our committing ourselves now to an objective of maintaining a ferry service should ferries prove uncompetitive with the CFL. Such an objective, once stated, would be seized on and relied upon by both ferry and port interests; we would risk saddling ourselves with an open-ended commitment - uncertain as to both cost and deliverability. We would be likely to have difficulty in justifying under the Treaty of Rome either any subsidies or any interference in the pricing policy of the CFL. We would have to distort the market at the expense either of users or the taxpayer. We would be blunting the stimulus that the CFL should provide to greater efficiency and better service on the part of other carriers both surface and in the air.

3 Of course if there is an overriding defence need then we must seek to meet it. But the cost of meeting it should logically fall to the defence budget and Michael Heseltine will no doubt wish to consider carefully the likely nature of the need and the most cost-effective way of meeting it.

4 As regards potential vulnerability, I accept that interruption of the CFL could be expensive and inconvenient. However we can reasonably assume that there will be other air and

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surface links with the Continent particularly as regards bulk freight traffic, and that these could be intensified in the event of any lengthy interruption. I do not believe that our concerns would justify the maintenance of an obsolete form of transport.

5 By all accounts the French, whose interests are of course much less than ours on this point, will be very reluctant to go along with any commitment to maintenance of the ferries. Nor does it seem reasonable to ask potential promoters of the CFL for their ideas on how a substantial ferry presence should be maintained.

What assumptions are they to make about what "substantial" means, about the nature and cost of the service which the ferry operators should provide, or about the financial position of the ferry operators?

6 You referred also to the question of whether our competition legislation could act rapidly enough to deal with ordinary anti-competition practices, and whether there would be jurisdictional conflicts with the French. We cannot guarantee the adequacy of our legislation. But it is legislation that is generally applicable and I would be reluctant to single out the CFL for special treatment. There is of course a possibility anyway that the legislation will be revised, if not before the CFL is operational, at least during the term of critical concern. On this question of jurisdiction, there could be awkwardness deriving from the different approaches in the two countries. But I do not regard it as practicable or necessary to seek to negotiate a special Anglo-French legal regime covering the CFL, and the competition rules of the Treaty of Rome will be of general application.

7 We should confine ourselves to the prevention of abuse of a dominant market position. I believe that the means exist to do this, and we can make it clear to potential promoters that we would do so.

8 Were duty free facilities to be continued at the ports without being introduced for the CFL, then the ferries would have a resulting competitive advantage. But it may well be that such discrimination would be unacceptable to any potential promoter - I note that the Banking Group's report on financial feasibility assumed that there would not be any such discrimination. I agree with you that, if the potential promoters put forward a strong case for the CFL also to have duty free facilities, we should be prepared to consider it. However we should not be misled into believing that providing duty free facilities for the CFL would be an easy option given its implications for other national land boundaries which, of course, cannot provide, under international obligations, such facilities.

9 I agree also that it should be for the potential promoters to propose a term for the concession. No doubt there will be

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considerable difference between the terms proposed for the different links and we may wish this to affect our consideration of them. As you point out this will probably become a matter for negotiation. In my view such negotiation will be a better basis for the decision than Government edict.

10 Your general principle that there should not be special rules should, in my view, also apply to the financial aspects of the guidelines. In addition, we must be careful not to impose unnecessary constraints on the financial structure of potential promoters. I hope that you will be able to reach agreement with the French on these aspects - "broad equivalence" seems an acceptably ambiguous phrase for the sharing of costs and receipts. In my view, the same principle should also apply to tax liability, ie we should not try to "ring fence" the project. Clearly any such attempt will affect the private sector's willingness to finance the project: a willingness that, given the Bankers Group Report, cannot be taken for granted.

11 Similarly the same general principle should guide our decisions on the financing of any associated infrastructure. On this basis, I am content with your proposals for both rail and road - provided that the expenditure implications for the latter are indeed relatively minor. In my view, it would be best if this proviso could be incorporated into the Guidelines.

12 I am copying this letter to the Prime Minister, other members of E(A), the Foreign Secretary, the Secretary of State for Defence and to Sir Robert Armstrong.

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NORMAN TEBBIT



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MINISTRY OF AGRICULTURE, FISHERIES AND FOOD  
WHITEHALL PLACE, LONDON SW1A 2HH

*NARM AT CMO*

*19/12*

*Zpp's*

*NBPM*

*AT*

*19/12*

From the Minister

The Rt Hon Nicholas Ridley MP  
Secretary of State for Transport  
Department of Transport  
2 Marsham Street  
London SW1P 3EB

18 February 1985

*Nicholas Ridley*

CHANNEL FIXED LINK

Thank you for sending me a copy of your letter of 12 February to Nigel Lawson. I should like to comment on certain points in your letter and in the paper accompanying it.

As you have noted, there have been a number of meetings and other exchanges between officials which have enabled clarification on some of the issues arising, to be obtained. In particular, we have emphasised that for animal health it is important both for practical and presentational reasons to ensure that the present controls designed to minimise the risk of importing animal disease are not weakened.

I cannot agree to one aspect of the juxtapositioning suggestion. It could affect the existing well-proven rabies controls which we apply. I should explain that under these arrangements only a carrier licensed by my Department may remove animals destined for this country (and licensed to enter beforehand) from the ship carrying them. If the controls were exercised on the other side of the Channel, it would be necessary for the licensed carriers to cross in order to collect the animals. I would not regard this as an acceptable arrangement because it would obviously place a premium upon seeking to avoid the control arrangements. Moreover, such an arrangement would be seen as more obstructive to freedom of movement than the existing one. On the other hand, if the control arrangements were applied on this side of the Channel it would be essential to add to the existing safeguards to ensure no contact between imported and indigenous animals took place between arrival on British soil and the control point in this country.

I am not altogether clear how other animal and public health controls, eg on meat imports, would be affected by the

/proposition: such ....

*Attached AT*



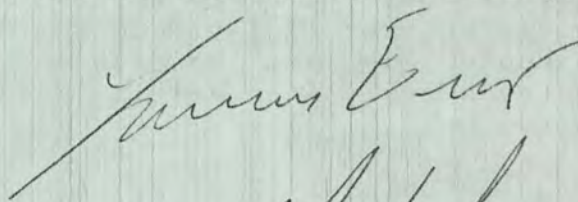

proposition: such imports have to enter through specified ports which have extensive facilities to undertake a physical examination of consignments. I am sure that all the interests likely to be affected would be extremely reluctant to see any weakening of these controls.

I should also like to confirm what my officials have already said about the reference in paragraph 30 of the note to a disease-free zone. I am afraid that we do not understand what is meant by this expression in relation to existing animal health arrangements. For example, what diseases are to be regarded as covered? And how would such a zone with the implied movement controls into and out of it be regulated? In short, this seems to be an unnecessary and unrealistic notion to be taken into account in considering the frontier control arrangements. If the intention is to describe arrangements to keep a tunnel, or bridge, free from wild animals (as we would wish) perhaps it would be better to say so.

I am concerned that you are contemplating the removal, at least in part, of duty-free facilities across the Channel. I agree that the promoters of the fixed link should be told that they cannot rely on the retention of duty-free facilities: these facilities are now rather an anomaly in the Community and their indefinite continuation cannot be guaranteed. However I would wish very careful consideration to be given before anything is said or done which would accelerate their disappearance or reduce the volume of duty-free trade across the Channel, since this trade is extremely important to the alcoholic drinks industry, particularly spirit drinks. About 10% of our Scotch whisky exports of nearly £1000m goes to Community duty-free outlets and the cross-Channel link must take a considerable part of this market. I would hope that a study of the consequences for our export trade would precede any bargaining with France or with the promoters concerning limitation of duty-free facilities.

I hope that what I have said will help clarify where we foresee problems of application from this Ministry's point of view. No doubt the points can be further discussed at official level.

A copy of this letter goes to the Prime Minister and other members of E(A), to Geoffrey Howe and to Sir Robert Armstrong.

MICHAEL JOPLING





DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Treasury Chambers  
Parliament Street  
LONDON SW1P 3AG

12, February 1985

*Dear Nigel*

CHANNEL FIXED LINK

I am attaching a copy of a paper that our officials have prepared reporting upon the current position in the discussions with the French on a Channel Fixed Link (CFL).

As you will know, the remit, agreed between the Prime Minister and President Mitterrand in November, is to advise Ministers on guidelines for potential promoters of a CFL by the end of this month. We are to consider the position formally in E(A) on 25 February, but on certain points the officials representing us on the Anglo/French Group are seeking our guidance now before the final phase of these official level discussions.

On several of the points raised in the paper, officials are merely seeking endorsement of the position they are taking, and I see no need to intervene to change the position.

As to the other points, I consider we should be guided by the same principles that led us to insist that a CFL, if it is to be constructed, must be carried out with private funds. Though unique in many respects, the CFL would be an internationally financed construction project (of which there are many) and might occupy a dominant position in the market it serves. As far as possible,



I consider we should avoid constructing special rules, either helpful to or against the CFL project, since that would undermine our wish to see the CFL stand or fall on its attractiveness as an investment opportunity relative to other projects.

On the crucial issue of the survival or demise of the ferries, however, I do not think we can afford to take a detached view. I think we must ensure that some competition by ferries is preserved on the Dover Straits route and that, overall, a sufficient ferry capacity is maintained to ensure that, bearing in mind the vulnerability of a fixed link, our defence requirements are met and alternative services are maintained in the event that communications across a fixed link are interrupted by strikes, blockades, accidents or political disagreements with future French governments. The indications at official level are that the present French government would be prepared to enter into confidential arrangements with us which would ensure that such interruptions were minimised both in scale and duration. But I do not think we can place our reliance on this. We need to keep open options which ensure that we are not placed at the mercy of one union or one pressure group and which enable us, if necessary, to divert traffic to countries other than France.

If you and other colleagues agree with this objective the question remains how we achieve it. The threat to the ferries might take the form of short term predatory pricing by a fixed link, taking advantage of its low operating costs. It might arise because, even on a full cost coverage basis, the fixed link proved to be more efficient than the ferries.

We could, leaving aside possibilities of intervention by the European Commission under Articles 85 and 86 of the Treaty of Rome, guard against the former by rapid intervention



under our monopolies and restrictive trade practices legislation. But could it be rapid enough and how would we deal with possible jurisdiction conflicts with the French - even though at present they seem ready to act with us against predatory pricing? We could agree with them measures to be taken through direct control of tariffs if certain objective criteria were satisfied, eg return on fixed link capital in excess of a specified rate or a specified rate of undercutting of ferry tariffs - though I would not wish to provide any inducement to ferry operators to go easy on securing efficiency improvements.

I am, at the moment, inclined to the view that we should state in the guidelines our requirement that a substantial ferry presence both on short and long sea routes should be maintained, leaving it to promoters to suggest how this might be achieved consistent with their need to secure an adequate return fully reflecting the commercial risks they would be undertaking. I would be grateful for my colleagues' views on this difficult question.

On the concession to the promoters, they will need to feel that they will have adequate time to earn a fully commercial return reflecting the size of their investment and their estimation of a realistic pay-back period. This period will depend upon the option we select. I suggest that we should allow promoters to seek to justify their own proposals on this, while retaining the right to indicate in the pre-construction stage a lesser period: this would of course end up as a matter for negotiation. I think we cannot exclude at this stage the possibility of a special tax or levy in the later years of a long or indefinite concession; but this must not be such as to deter them from risk-taking.

On duty free facilities, I am inclined to the view that we should not encourage fixed link promoters to think



that these would be available. Discrimination here may be the tool we need to ensure that ferries survive in competition with the fixed link. I suggest we leave it to the fixed link promoters to argue their own case. If they insist that such facilities are essential they will be demonstrating that their efficiency relative to the ferries is artificial. We may have problems with the French on this but I am ready to argue them out with my French counterpart.

On the various financial questions, officials ask us (paragraphs 6-10) to decide upon constraints upon the sharing of costs and receipts between national companies. I would personally prefer to see no constraints placed upon private investors in this respect. But I believe we could give our officials discretion to agree to a loose formula such as "broad equivalent" if that appeared to satisfy the French.

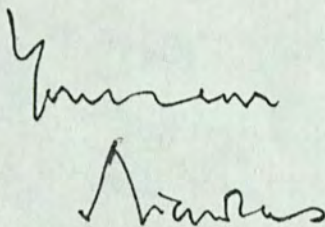
On the need to protect the Government's tax revenues, I believe we should look carefully at the case for "ring-fencing" or other options. The parallels with North Sea exploitations are not perfect, and the new rules on capital allowances have changed the overall position. But we are nonetheless dealing with a project which, once the initial investment is recovered, could make very large profits.

Finally, I agree the position that has been put to us by our officials on BR's involvement. We should not deceive ourselves by thinking that the French will readily accept this, but it is the right negotiating position and we can consider it further at E(A) on 25 February, when the French position may be clearer. On inland road infrastructure (para 25 of the paper) I consider that we should take responsibility for the relatively minor expenditure as part of the roads programme.



We need to take decisions on all these matters before officials can agree the guidelines with the French; I would therefore be grateful for comments by Friday 15 February; my officials have already been in touch with officials in most interested Departments.

I am copying this letter to the Prime Minister and other members of E(A), to the Foreign Secretary and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Nicholas Ridley', written in a cursive style.

NICHOLAS RIDLEY



CHANNEL FIXED LINK: CURRENT POSITION IN ANGLO/FRENCH NEGOTIATIONS

1. The Anglo/French negotiations aimed at agreeing guidelines for potential promoters of a Channel Fixed Link (CFL) are due to be completed by the end of the month. A number of areas have now emerged where officials require policy guidance from Ministers, either because there are conflicting views in Whitehall, or because the position which officials are agreed should be taken is meeting with opposition from the French. There are certain other areas where, although officials are in agreement about how we should proceed and do not seek immediate guidance, they believe Ministers may wish to take note of the current position.

A. Nature of the "Concession"

2. Although both Governments are agreed that any CFL project must be a private sector one, standing or falling on its ability to attract the necessary private finance, the selection by the Governments of one particular scheme to be facilitated through legislation and a treaty will amount to a "concession". It would be open to the Governments to place limits upon such a concession - for example, to specify that it would be granted for a period that the Government would decide, perhaps 30 years, after which the structure would become the property of the government. Alternatively the promoters could have the right to exploit the link in perpetuity.

3. It is expected by at least some prospective promoters that the concession will have a finite term. The French have said they will regard 50 years as the absolute maximum. They suggest a promoter would regard himself as in danger of nationalisation if the concession were very long or indefinite. Equally the French accept that the term chosen should allow promoters a reasonable prospect of earning rewards for their risks.

4. The period taken for a project to return a profit will vary from one proposal to another: it would be longer for EuroRoute than for a rail "ferry" tunnel. Although it would be possible to set a maximum limit for the concession - say 50 years - in practice this would encourage all promoters to use this



figure in their own proposal. Officials therefore believe that the guidelines should state that the arrangement between the government and the promoter will be in the nature of a concession, but that the Governments will expect the promoters to propose how long the concession should be.

5. Naturally it would be a requirement that the holder should hand over the link in a good state of repair.

#### B. Financial Structure and Taxation

6. The French want the concession to be granted to two companies, one controlled in France, the other in the UK. Majority ownership of each company would be confined to nationals of the respective state. The French also want to require the companies to share costs and revenues equally.

7. For political reasons, neither country would probably want to concede a dominant position to the other's company. The arguments could include the ability to take control in time of emergency. We believe the French will not easily drop the requirement for two national companies, though we are putting to them possible difficulties in Community law.

8. Sharing costs and receipts is intended by the French, on the basis of experience with Alpine tunnels, to help ensure successful completion of the work. It would also ensure each country had taxing rights over half the eventual profit. We have suggested that the same result would follow by simply sharing revenues, at some saving in Governments' supervisory roles.

9. However, we have also asked the French whether common objectives might not be better achieved by telling promoters the Governments would expect "broad equivalence" in the role of the two companies. This would avoid putting specific requirements, before the concession is made, on the form of the financial arrangements.



10. The French hold to their insistence on national ownership of majority shareholdings despite agreement that the terms of the concession would provide the principle means of control by Governments. We doubt whether what they propose would be possible within Community law, even with a golden share. We have asked the French to explain their position.

11. A further issue is whether the national companies should be restricted in setting tax allowances on other activities against their operating profits. In principle this would enable the Governments to tax profits when they were made and not, in effect, wait to tax the earnings of those profits. However, it would deprive the controlling companies of the normal tax treatment of their investment programme. Governments would still be left with the task of finding ways, over and above the normal tax system, to cream off excess profits, if they wished to do so.

#### C. Competition with Ferries and Price Controls (Annex A)

12. A CFL, whatever its form, will enjoy considerable market power in the Dover Straits. It will be important to ensure that it does not abuse its dominant position, whether by colluding with the ferries to fix unreasonably high prices, or by predatory pricing to drive the ferries out of business. There are relevant provisions in the Treaty of Rome that are probably capable of dealing with this situation but they are largely in the hands of the Commission. National competition legislation will also be available, but consideration may have to be given to a common regime.

13. However, it is possible that, without any anti-competitive practices on the part of the CFL operator, the ferries will be unable to compete. Ministers also need to consider, therefore, whether it should be an objective stated in the guidelines by the two Governments to prevent the Link developing a market dominance which could threaten the continued existence of the ferries. The pros and cons of such an objective are set out in paragraphs 4 and 5 of Annex A, together with a possible form of words for the guidelines. Ministers should be aware that the French may not agree with this and the guidelines may emerge as a statement of the UK position alone. The arguments for the maintenance of the ferries rest mainly on the defence



requirements and on the UK's possible economic dependence  
a Link. On both these issues further work may be needed  
after the guidelines are issued. The main arguments against  
are that it would be costly and paradoxical to maintain what  
would be a more expensive and less competitive mode of transport  
in order to preserve "competition".

#### D. Involvement of British Rail - Rail Infrastructure Costs

14. It is by no means certain that a CFL will include a rail  
element. Officials in the UK believe that to insist upon it  
would be inconsistent with our general approach that the future  
of the project - whether it goes ahead at all - should be  
determined by the private sector. The French also say firmly  
they would not wish to insist upon a rail element, though  
we believe this is disingenuous given their undoubted wish  
to run suitably adapted TGVs to London. With the EuroRoute  
and Eurobridge schemes a rail tunnel would be virtually a  
separate project, and the incremental cost of providing it,  
purely to provide for "through" trains, would be very high.  
With the twin 7-metre tunnel scheme, provision for through  
trains in addition to shuttle vehicles (which would be owned  
and operated by the main CFL promoters) would add little to  
the cost of the tunnel itself but would still lead to inland  
infrastructure costs of £200m-£250m, and a further £60m for  
rolling stock, on the British side alone.

15. Officials' approach has been that any BR involvement must be  
on a fully commercial basis and that, so far as practicable, BR  
involvement should be consistent with the policy of "no public  
funds, no guarantees" for the CFL.

16. Officials therefore propose that the draft guidelines should  
say that:

- (1) there will be no Government financial assistance to BR  
for infrastructure or rolling stock investment or for  
the operation of through services



- (2) any BR capital expenditure will have to be on a strictly commercial basis, applying the tests already applied to BR's optional investment
- (3) any BR capital expenditure which does not meet the usual tests will not go ahead unless it is financed by the promoters.

17. BR are likely to be content with such guidelines. But the French find our approach difficult to understand (since they themselves expect to pay SNCF's costs direct from Government funds); they believe that the promoters would not be willing to pay BR's infrastructure costs; and suspect we are deliberately erecting obstacles to a rail element.

18. Criteria for BR Investment and Operations. BR are expected to earn a 7% DCF return in real terms on optional new investment projects. Officials advise that, despite the French reservations, this should be an absolute requirement for any BR-funded investment associated with the CFL. Less demanding requirements for such investment would: make it more difficult for BR to meet its financial targets; give BR the wrong signals about the need to invest commercially; and be inconsistent with the Government's commercial approach to the CFL.

19. This requirement means that BR's own capital expenditure must be limited to what they can get a return on. The remainder of the capital will have to be provided by the promoters. In practice, the promoters may have to make a large contribution to BR's capital requirements. If BR had to fund all the works and rolling stock required, they would need a net gain in operating surplus of the order of £20m-£25m a year to provide a return on that investment. This looks implausible, though at this stage there can be no certainty. So Ministers should be aware that if the requirement for BR's usual financial return is treated as an absolute condition, and if little or none of the capital is provided to BR as a free good by the promoters, it may rule out any CFL with through rail services, and schemes which depend on through rail traffic as a component of their financing.



10. Public Expenditure. Even if any BR investment were financially justified, this would increase public expenditure. So public sector borrowing would be higher in the years in which the investment was made; when the project began to earn a return for BR, their requirement for external finance would be reduced. This additional demand for public sector borrowing would be inconsistent with any insistence that the CFL should be wholly privately financed. Ministers have these options:

- (1) to require that there should be no BR-funded expenditure, leaving the promoters to meet BR's capital costs
- (2) to allow BR to borrow to fund that part of the capital expenditure which they could justify commercially.

21. Option 20(1) would avoid additional public sector borrowing. But there would be no logic in trying to force the promoters to finance that part of the scheme from which BR would take the commercial gains; and it would be inconsistent with general policy for nationalised industries to rule out opportunities for commercial investment simply because they would have to be funded by borrowing. This option, as an absolute requirement, might rule out through rail services, since the promoters may not be willing to tie themselves to covering all BR's costs; since the French place such importance on rail links, such a requirement could lead to accusations of bad faith and have wider repercussions.

22. Option 20(2) would necessarily mean higher public sector borrowing. It would also give the promoters a very strong financial incentive to encourage BR to take as optimistic a view as possible of the future return to BR from through rail services; and BR may in any case tend to be over-optimistic. Nevertheless this option would be consistent with present policy for BR investment; is in principle the correct way of apportioning responsibility for capital costs between BR and the promoters; and may be necessary if the rail option is to remain open. The proposed guidelines (para 16 above) follow this option.



Guarantees. Officials have been concerned about BR entering into contracts with the promoters which specify a minimum number of train paths which BR would take up. In principle any such undertakings would amount to public sector financial guarantees. But so would any BR commercial contracts. Such contractual undertakings would be significant as public sector financial guarantees only if BR were very imprudent in estimating minimum future traffic. Ideally, BR would aim in negotiations to get the promoters to offer a minimum number of trainpaths, sufficient to meet BR's market expectations, without BR guaranteeing to take them up. But it would be unrealistic to expect to sustain an absolute requirement that BR, in such negotiations, could offer no commercial undertakings of any description about the train paths they would take up. So this may be a matter best left to pressure on BR from the Government rather than being specifically covered in the guidelines (apart from the general requirements that BR must operate commercially).

24. The draft guidelines on BR involvement will not be welcome to the French, and we expect them to raise the matter with British Ministers once the Working Group's report is complete. But the draft guidelines represent in officials' view the minimum requirement to ensure that BR does not make uncommercial investments and that public funds are not put at risk.

#### E. Road Infrastructure

25. Very little road infrastructure would be required because of the Link's construction. Though it must be checked out against promoters' claims on capacity and traffic, improvements in the road network already planned should be adequate (see para 26 below). The only additional construction necessary should be service road connections between the end of the bridge or the tunnel portal and the trunk/motorway road network. The distance in either case should be short. The question is whether we should insist that these connections are financed by the link promoters. The French take the view that it would be wrong so to insist.



26. Construction of M20 Maidstone-Ashford section and replacement of A20 between Folkestone and Dover are firmly programmed. While it is open to Ministers to remove such schemes from the programme they are required to serve cross-channel traffic in the absence of a fixed link and to meet Kent needs. The form of the Folkestone-Dover scheme might need amendment - possibly at promoters' expense - if the Link terminal moved from its earmarked site. Further increases in road capacity not yet firmly programmed are contemplated on the Medway Towns section of M2 and, for the late 1990s, on the Maidstone bypass whose capacity is lower than the remainder of the M20 route. Such needs will need to be met whether or not there is a fixed link. Programmed schemes and further needs arising naturally would fall to be met from the Roads Vote, and the same general principle would apply to Government support for Kent's local road programme.

#### F. DUTY-FREE FACILITIES

27. The French have proposed that the UK and French Governments should encourage the European Commission to take an initiative to remove duty-free facilities from all intra-Community sea traffic. This, they say, would ensure equal treatment for the ferries and the link. We think the idea impracticable, not just because of likely opposition but also because the UK, in recent Community discussions, has supported draft legislation formalising duty-free sales in intra-Community travel.

28. The French suggest that an alternative means of securing equivalence with ferries would be to concede duty-free facilities on the link, other than on trains. Customs believe this would conflict with international understandings. It could lead to repercussions on the Irish land boundary, where duty-free facilities are not provided, and cause problems, too, for other Community states with land borders.



-9-

G. FRONTIER CONTROLS

The French, whose tunnels to Italy have controls only at one end, are asking us to defer decisions on the location of controls while the EC Draft Directive on frontier facilitation is considered. We have resisted, saying that promoters should expect to provide facilities on both sides capable of handling the customs and corresponding personal controls of each country in the normal way.

30. Our reasons include the maintenance of stricter controls over the import of drugs and animals, etc. Any form of juxtaposition would make a disease-free zone dependent solely on link operators taking all reasonable steps to ensure unauthorized animals were not admitted to the link. Controls wholly on the French side might cause difficulties in bringing goods and persons involved in irregularities and offences back to the UK; and reduced French customs formalities for goods at importation, deriving from extensive use of inland clearance, could lead to pressure to relax British controls, which are largely port-based. Juxtaposition of controls in both directions on the British side would mean a greater environmental impact through the size of facilities required, and lead the French to expect extra-territorial rights, including the right of arrest on British soil. Juxtaposition of controls in each direction at the port of entry would involve similar juridical difficulties. Any scheme involving basing staff in France would be costly.

31. We have suggested as well that the scope for saving time for users of the link is more limited than it might at first appear. In practice, security arrangements would demand a stop on entry to the link. Even with juxtaposition at entry there would still be separate British and French checks. There is some understanding among the French for our position, which we will be explaining to them in some detail.



H. Territorial Question

31. The French are concerned that, between the UK 3-mile territorial limit and the French 12-mile limit, the UK will have no right under international law to authorise the erection of obstacles in the Channel. They have warned us that unless French concerns are met they will be unable to support us if our actions are challenged as the French believe they will be, in IMO or by other countries, with consequent lengthy delays in carrying forward the project. The options open to us are either to extend our territorial limit to 12 miles or to declare an Exclusive Economic Zone (EEZ). Each of these options presents difficulties for the UK; these are explained more fully in Annex B . Officials from relevant Ministries will now look at this question urgently. But it will almost certainly not be possible to provide definitive guidance on this to the companies at present.

8 February 1985



CHANNEL FIXED LINK : COMPETITION WITH FERRIES

1. A CFL will be a major commercial development on the short-sea Channel crossings. It will raise difficult questions as to the appropriate legal and institutional framework for applying competition policy to it. Most of these questions can be left for detailed study as the CFL concept develops. Some involve the application of the competition rules of the Treaty of Rome which are dealt with separately. But the guidelines to would-be promoters must give some guidance as to what the two Governments' policy objectives as regards competition will be (taking account of all the public interest considerations that arise in what will amount to a public franchise).

2. An overall policy objective must be that the CFL should not abuse any dominant market position that it acquires. This will be required by the Treaty of Rome and is consistent with the competition legislation of both the UK and France. It entails a commitment to a legal framework that will be able to prevent eg. predatory pricing as well as collusion between the CFL and ferry operators. Issues that will require later detailed consideration will include whether the respective domestic competition laws should apply at either end or whether a common regime should be considered.

3. The effect of the CFL on the cross-channel ferries is unpredictable. The CFL will have physical capacity constraints and its operators will have to meet high financing charges as well as continuing maintenance, security and operating costs. But the CFL will have substantial advantages in terms of time and convenience. Whether the ferries will remain competitive (either in their present form or by offering a different service) cannot be foreseen at present. But it is conceivable that the CFL could have such decisive commercial advantage as to threaten the viability of any ferry service on the short-sea routes. Ministers additionally need to consider whether it should be an objective, stated in the guidelines, to maintain competition to the CFL by ferries (implicitly even if the ferries are not competitive with the CFL in the ordinary commercial sense).

4. The arguments are:

- (i) Vulnerability The cost to the UK economy of a major interruption of a single link because of eg. industrial action, accident or sabotage might be considered to be so high that it would be prudent to maintain at least some alternative short sea route facilities.



However, existing ferry services are already vulnerable to interruption. The effects, of interruption to CFL-only links would, as now, depend on the availability of air links and of ferry services on the longer routes.

- (ii) Competition. It will not be sufficient to prevent abuse of a monopoly. An alternative to the CFL is desirable to provide a constant competitive spur to efficiency and deterrent to exploitation as well as to extend the range of services available to the customer. Because of the need for docks and the high cost of ships, ferry services once lost would be difficult to replace.

However, competition policy does not require the perpetuation of an uneconomic activity. If economies of scale or technical advantage result in a monopoly, prevention of the abuse of monopoly is the appropriate policy response.

- (iii) Defence. The CFL would be far more vulnerable to sabotage during a time of tension than ferries. UK planning for reinforcement of Europe in times of emergency and war may therefore continue to depend on the availability of suitable ro-ro ferries. There are about 70 such ferries on UK registry at present, 20 operating out of Dover and Folkestone and another 15 out of other ports between and including Southampton and Harwich. The likely defence need is for about 50 ferries. Without the Dover/Folkestone ships, which are better suited to defence needs, there will not be enough to meet all defence needs. If services out of Harwich and Southampton and other intermediate ports were also reduced, the shortfall would be worse. (Other NATO ferry operation operators and indeed those ports (UK and Continental) themselves would also be affected).

But the cost of any subsidy provided for defence reasons to keep ferries going would logically fall on the Defence Budget, and alternative ways of meeting the need, eg. mothballing ships or relying on ships of NATO allies, would therefore have to be considered very carefully and fully.

- (iv) Continuity. The effect of the CFL will be felt before it is operational because of the ferry operators' need to make investment and commercial decisions well in advance. Unless the operators are assured that a role for ferries will be maintained they might well run down their services before the CFL becomes operational.



But any degree of assurance about ferry services would be likely to weaken the ferry operators' incentives to improve their efficiency.

- (v) Cost. If the ferries are (without special measures) uncompetitive with the CFL their retention will require either maintaining CFL prices higher than necessary or a subsidy to the ferry operators or differential treatment (eg. no CFL duty-free, or a levy on CFL users payable to the ferry operators). Higher prices will deprive users of the full benefit of the CFL; a subsidy or discrimination against the CFL would reduce the traffic carried by the CFL. A subsidy would be a public expenditure addition and probably contrary to the Treaty of Rome. Differential treatment would be discriminatory (to the benefit of the ferry owners).

5. Ministers are asked

- to endorse that it should be a stated objective to control anti-competitive practices in the market served by the CFL.
- to decide whether the guidelines should contain any implicit limit to the extent to which a fixed link might be allowed to monopolise the UK's surface communication with the Continent.

6. A draft guideline on competition might be (with the words in square brackets only remaining if Ministers wish to make a commitment to the maintenance of competition to the CFL):

"The two Governments would view the relative merits of possible schemes against their agreed objective[s] of [extending the range of and of] improving the efficiency of cross-channel communication in the interest of the user whether business or personal. The Governments will accordingly ensure that adequate powers and machinery exist [to limit, if necessary, the extent of market dominance of a fixed link and] to control anti-competitive practices in the market served by the link."



## TERRITORIAL JURISDICTION

1. At present, the territorial sea of the United Kingdom extends only three miles, whereas the legislation of France provides a breadth of twelve miles. Certain of the schemes for a Channel Fixed Link would involve construction works being undertaken and/or permanent structures being built in the area, at present, the high seas, between the British and French territorial seas, and the French have expressed doubts about the right of the United Kingdom under international law to authorise these works in this area. We have argued that we do have a right under customary international law to authorise the undertaking of these works but that, even if we did not, nevertheless as part of the concept of the 'Exclusive Economic Zone' (which we recognise as valid under international law even though we have not as such declared such a zone) a coastal state may authorise the construction of artificial islands, installations and structures in an area out to 200 miles from its coast for economic purposes including transport tunnels. The French nevertheless remain unhappy, and have said that if there were a challenge in an international forum (such as IMO) to the UK's right to authorise the undertaking of these works in the area of the high seas, they would be unable to support the UK's position; this would, of course, be rather embarrassing and might encourage the opponents of the scheme.

2. There are two possible solutions:

i) the UK could extend its territorial waters to twelve miles. We understand that so far the MOD have resisted this because of the question of securing transit passage for warships through international straits, since the UK is not a signatory to the United Nations Law of the Sea Convention. We believe it will be difficult to justify remaining at 3 miles. Any approach to IMO will have to take a clear position on this. The only reasonable way of dealing with this in the Guidelines to the companies would be to inform them that they should proceed on the footing that by the time construction began, we would have a territorial sea of 12 miles. This requires legislation which is in preparation but the need for



Parliamentary approval would have to be borne in mind in any public reference to the point. Ministers will need to reconsider this problem in the light of this new difficulty which has emerged;

ii) The UK could declare an Exclusive Economic Zone, even if only for the area of the construction works for the Link. The French intimated this week that they could probably accept this, provided that the rights claimed were the whole rights which may be claimed as part of an EEZ, or very nearly so. This solution is much less satisfactory. The EEZ concept is closely linked to UNLOSC and in that Convention it is qualified by a clause which disallows uninhabitable rocks, such as Rockall. It would be difficult to resist calls for extension of an EEZ to areas outside the Channel and this would bring into discussion our existing 200 mile fishery limit around Rockall.

3. Officials should consult urgently on the options above, and report as soon as possible. Thereafter there may need to be further discussion at Ministerial level. In the meantime, the Guidelines should go no further than to recognise the existence of the problem and our intention to consider ways of dealing with it.



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