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P.0645  
PRIME MINISTER

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FIXED CROSS-CHANNEL LINK  
E(82)7 and 9

BACKGROUND

In E(82)7 The Secretary of State for Transport seeks approval of the line he wishes to take on reciprocal guarantees between the United Kingdom and French Governments, in the event of agreement to build a link, and on the requirements for private sector financing of the project. In E(82)9 the Central Policy Review Staff (CPRS) recommend an alternative approach to the problem of private sector financing.

2. The immediate issue is confined to these questions of guarantees and of financing arrangements. The Secretary of State for Transport will put forward a comprehensive report in March dealing with the technical, economic and financial considerations which will form a basis for the Government's decision on whether to go ahead and if so when and with what sort of link. He needs guidance in the meantime on the financing questions so that he can give a steer to the further work.

MAIN ISSUES

3. The French Government insist that if the link is to go ahead they must be able to exchange reciprocal compensation guarantees with the United Kingdom Government. Under these reciprocal guarantees either Government would reimburse the costs of the other if work on the link was abandoned as a result of:

- either (i) a political decision to withdraw
- or (ii) failure of the Government's 'chosen instrument' i.e. on the UK side the failure of the private sector promoters.

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The costs to be paid to the other side would include those directly incurred by Government and those of the contractors. The Secretary of State for Transport believes that if there is agreement on these reciprocal guarantees the French will drop their pressure for the Governments to be able to regulate tariffs.

4. In public statements the Government has made it clear that it is seeking proposals that can be financed without recourse to public funds but it has acknowledged the need to give some guarantee or indemnity to the private promoter against a political decision to cancel the project. A reciprocal guarantee covering political withdrawal by either Government is consistent with this position; the CPRS do not question the judgment that a reciprocal compensation guarantee, extended to cover failure of the chosen instrument, will be necessary.

5. The difference between the Secretary of State for Transport and the CPRS is on how best to deal with the failure of the Government's chosen instrument. The Secretary of State for Transport believes that, if it is accepted that the reciprocal guarantee must be given, it is better to reinforce the UK promoter by a completion guarantee whereby, in the last resort, the Government would step in to ensure the provision of finance to enable the project to be completed. The CPRS recommend that the completion guarantee should be given to the Government by the promoter and not the other way round.

6. The Secretary of State for Transport's proposals for a completion guarantee are set out in paragraphs 14-18 of E(82)7. He envisages that to give him a sharp incentive to raise the money from the markets, without recourse to the Government, the promoter would lose all or part of his equity share in the link and could face (unspecified) financial penalties if the Government's guarantee were called; he does not say whether there would be any limit on the Government's obligation to secure additional financing to ensure completion. He advises, in paragraph 18 of E(82)7, that such a completion guarantee would make it much easier for the

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promoters to raise finance on a basis less dependent on assurances from the two railway companies; this is no doubt because while the equity would be at risk - probably 5-10 per cent of total financing costs - loans would not.

7. The CPRS point out that, notwithstanding the possibility of penalties, the promoter would appear to have an open-ended right, under the Secretary of State for Transport's approach, to call on the Government for additional financing. They advise that the more commercial approach would be for the Government to seek a completion guarantee from the promoter backed by a charge on the promoter's business and assets and involving the financiers of the loans in some of the risks. If the promoter then failed the Government would take the initiative, could appoint a receiver, and could choose between the alternatives listed in paragraph 5 of E(82)9 and including withdrawal from the scheme. The CPRS suggest that if it is thought that this approach could lead to difficulties in raising finance there must be doubts about the financial viability of the project.

8. The Secretary of State for Transport, in paragraph 19 of E(82)7, seeks agreement that the French Government's requirement for reciprocal guarantees covering not only the political risk but also failure of the chosen investment, should be accepted as a basis for further discussions and that he should further explore possible private sector financing arrangements. Whatever view is taken on the relative merits of the alternative approaches to completion guarantees, this does not seem satisfactory. The Committee cannot agree to reciprocal compensation guarantees relating to failure of the chosen instrument without being clear what would be the contingent financial liabilities that the Government would be accepting; and that will not become clear until there have been further discussions with the prospective private sector promoters and their financial advisers. This points to agreeing a basis for further discussions but not to going so far as to give a firm commitment on covering failure of the chosen instrument.



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HANDLING

9. After the Secretary of State for Transport has introduced his paper you will wish to ask Mr Ibbs to explain the CPRS' alternative approach. The Committee will then wish to hear the views of the Chancellor of the Exchequer.

10. The main questions before the Committee are:-

(i) Whether to give reciprocal compensation guarantees related to a political decision by either Government to withdraw.

(ii) Whether to extend such reciprocal guarantees to failure of the chosen instrument.

(iii) If so, whether to adopt the approach recommended by the Secretary of State for Transport or by the CPRS.

(iv) What should be said at this stage to the French Government.

11. The Committee may conclude that the right course is for the Secretary of State for Transport to seek further advice from Schrodgers, who are advising his Department, on the options including that suggested by the CPRS. The French might be told that the Government would be willing, in the event of the link going ahead, to enter into reciprocal compensation guarantees related to political withdrawal and that it was willing to examine further the possibility of extending these guarantees to cover failure of the chosen instrument on either side. It would be made clear, however, that the Government's decision on the latter point would depend on the outcome of further discussions with the private sector interests involved.

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CONCLUSIONS

12. In the light of the discussion you will wish to sum up with reference to the four main questions listed above and so to give the Secretary of State for Transport guidance on the line he is to take pending further discussion by the Committee of his substantive proposals in March.

*Pg*

P L GREGSON

8 February 1982

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1. The CPRS accepts Transport's arguments that it would be reasonable to have a reciprocal compensation guarantee if either Government abandoned the project. They believe that there is a need for a Government guarantee against a political decision to cancel the project.
2. In my memorandum of 5 February 1982 I argued that it is difficult to determine whether an action is political or commercial. If there is disagreement between the two governments over commercial viability and one wishes to withdraw, then it seems to me very difficult to avoid representing this as a political reason. But it may be nothing of the kind. I cannot see how a viable agreement can distinguish the purely political reasons from commercial justifications.
3. I agree with the CPRS view that no guarantee should be given by Government regarding the completion of the project. They suggest instead that the UK promoter give a guarantee to Government. I am not sure what is the underlying rationale for the promoter guarantee, as distinct from the Government guarantee. CPRS anticipate that if the tunnel is not completed then the Government takes over the existing asset (plus any agreed forfeit). This certainly adds to the promoters incentive to finish the job - but since they will have sunk hundreds of millions anyway, I suspect that is incentive enough.
4. But I am perfectly certain that the promoter guarantee will cost Government something. Just as there is no free lunch, so there is no free guarantee. For example, the price which the Government would have to pay for such a completion guarantee would take the form of the Government, on its part, guaranteeing all the necessary links and administrative arrangements. If these were delayed, then the Government would pay a forfeit.
5. And if the promoter faced not merely the unforeseen cost overruns but also the loss of all his equity (and more), he will clearly demand a premium for such a remote but devastating contingency.

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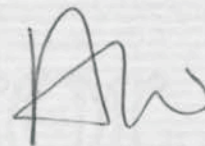
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6. On the whole I am nervous about providing a completion guarantee either way. As I understand it, the BSC consortium did not envisage a completion guarantee from Government, and I suspect they would shy away from providing one unless there was a suitable quid pro quo.

8 February 1982



ALAN WALTERS

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From the Secretary of State

The Rt Hon David Howell MP  
Secretary of State for Transport  
Department of Transport  
2 Marsham Street  
London, SW1P 3EB

8 February 1982

Dear David,

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In advance of E Committee's discussion tomorrow on your paper E(82)7, it might be useful for me to let you and colleagues know of my concern at the implications of the French proposal for reciprocal guarantees. The proposition is that we guarantee to pay all French costs in the event of a failure of the United Kingdom promoter. To my mind, this is unacceptable for two main reasons:-

a we have given our word, in repeated public pledges, that any fixed link would be a private sector project dependent on free market economics and finance, without any Government financial involvement directly or by guarantee. To do otherwise would be a particular breach of faith with the shipping industry. Yet this would be the inevitable consequence of the proposition before us; and

b we are asked to accept an open-ended commitment of the kind which proved so expensive for Concorde. We should be tied to the forecasting accuracy and operating efficiency of the United Kingdom promoter; tied also to the effects on the project of outside factors affecting its economics; and generally at the mercy of the French.

I am sending copies of this letter to the Prime Minister, E Committee colleagues, Sir Robert Armstrong and Robin Tibbs.

Yours

John Biffen

7 1982



11/11/82