EUROPEAN COMMISSION

Brussels, 18.09.2002
C(2002)3336 fin

Subject: State aid N 523/2002 – United Kingdom
The Channel Tunnel Rail Link (CTRL IV)

Sir,

Procedure

1. By letter of 30 May 2002 the UK authorities notified to the Commission certain modifications to the financial support measures currently in place for the construction of the Channel Tunnel Rail Link (CTRL). The UK authorities provided additional information by letters dated 19, 26 and 27 June 2002 and on 7 and 8 July 2002. The notification was registered by the Secretariat General of the European Commission on 12 August 2002 as State aid case No. N 523/2002. The Commission received further information via e-mail on 19 August 2002.

Background and previous Commission decisions

2. The Channel Tunnel Rail Link will provide a high-speed rail link connecting the UK with the growing European network of high-speed railways and the continental European transport system. On 28 February 1996, the UK Government and London & Continental Railways limited (LCR) entered into an agreement relating to the design, construction, financing and maintenance of the Channel Tunnel Rail Link between St. Pancras station and the Channel Tunnel portal at Cheriton. The public financing measures were initially notified to the Commission, which, on 22 May 1996, concluded that the financing did not constitute State aid.\(^1\)

\(^1\) Commission decision of 22 May 1996 (N 234/96), OJ C 168, 12.6.1996

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3. Subsequently, in 1998 the CTRL project was restructured and the revised arrangements were authorised by the Commission by virtue of Article 87.3 (b) of the Treaty and Article 3.1 (b) of Regulation 1107/70\textsuperscript{2}. Following the 1998 restructuring, the CTRL was to be built in two sections, Section 1 (south) and Section 2 (north). While LCR remains contractually committed to build the CTRL in its entirety, Railtrack Group committed itself, through its subsidiary Railtrack UK Limited (RTUK), to purchase the infrastructure assets of Section 1 and entered into an option to purchase Section 2. In return, RTUK was granted a concession to operate the CTRL and St. Pancras station and to receive access charges payable by Eurostar and other operators.

4. In light of subsequent financial difficulties of Railtrack Group and its decision not to exercise its option to purchase Section 2, the CTRL project was subject to further restructuring in 2001. Following the 2001 restructuring, Sections 1 and 2 would have had different infrastructure owners (RTUK and LCR respectively) but have common operation/management under RTUK. The revised CTRL arrangements were authorised by the Commission on 24 April 2002 by virtue of Article 3.1 (b) of Regulation 1107/70 and Article 87.3 (b) of the Treaty.\textsuperscript{3} Following the 2001 restructuring the public financial support put in place for the CTRL project can be summarised as follows:

\textit{Table 1: Summary of existing financial support for the CTRL following the 2001 restructuring.}

<table>
<thead>
<tr>
<th>Public support measure</th>
<th>Amount of aid</th>
<th>Beneficiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital grant</td>
<td>£ 555 million</td>
<td>LCR</td>
</tr>
<tr>
<td>Deferred grant</td>
<td>£ 1,036 million</td>
<td>LCR</td>
</tr>
<tr>
<td>Domestic Capacity Charges (DCC)</td>
<td>£ 416 million</td>
<td>RTUK (Section 1) LCR (Section 2)</td>
</tr>
<tr>
<td>Government guaranteed bonds</td>
<td>£ 3.75 billion (nominal value)</td>
<td>LCR and /or the final infrastructure manager of CTRL</td>
</tr>
<tr>
<td>Track access charge guarantee</td>
<td>n/a</td>
<td>RTUK (Section 1) LCR (Section 2)</td>
</tr>
<tr>
<td>Track Access Charge support (TAC)</td>
<td>up to £ 184 million</td>
<td>EUKL and/or the final infrastructure manager of CTRL</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>£ 120 million</td>
<td>RTUK</td>
</tr>
<tr>
<td>Hedging Guarantees</td>
<td>£ 13 million, unlimited Government exposure</td>
<td>LCR</td>
</tr>
<tr>
<td>Interoperability costs</td>
<td>N/a</td>
<td>LCR</td>
</tr>
</tbody>
</table>

\textit{Description of the notified aid measure (2002 restructuring)}

\textsuperscript{2} Commission decision of 18 January 1999 (N 576/98), OJ C 56, 26.2.1999

\textsuperscript{3} Commission decision of 24 April 2002 (N 706/2001), OJ C 130, 1.6.2002
General context

5. Following further financial difficulties Railtrack Group has decided to dispose of its interests in the CTRL (currently held by its subsidiary RTUK) to a combination of LCR and Network Rail. LCR will purchase RTUK from Railtrack Group and, subsequently, sell on the operating rights to Network Rail by virtue of an agreement made between LCR and Network Rail at the time of LCR’s agreement to acquire RTUK from Railtrack Group. Consequently, LCR will become the sole owner of the CTRL (Sections 1 and 2) infrastructure whereas Network Rail will acquire the rights and obligations in relation to the operation, management and maintenance of the CTRL and St. Pancras station.

6. It follows that Railtrack Group’s disposal of its interests in the CTRL will necessitate modifications to the financial mechanisms currently in place for the project. Therefore, the purpose of the present restructuring of the CTRL project (2002 restructuring) is to take due account of the changes brought about as a consequence of the fact that Railtrack Group will no longer play a part in the construction/management of the CTRL. In particular, the 2002 restructuring will bring about changes in respect of the beneficiaries of the public support but also with regard to the use of funds available under the existing scheme.

Beneficiary

7. It follows from table 1 above that Railtrack Group, through RTUK, is identified as the beneficiary of certain financial support as the envisaged infrastructure owner/manager of Section 1. Following LCR’s and Network Rail’s acquisition of RTUK’s interests in the CTRL, the beneficiaries will instead be LCR and Network Rail, respectively. In particular, LCR will become the beneficiary of the Domestic Capacity Charge (DCC) and the Track Access Charge Guarantee in respect of both Section 1 and Section 2.

8. As regards Network Rail’s purchase of RTUK’s rights to operate CTRL and St. Pancras station it is recalled that the Commission, in its decision of 17 July 2002, decided not to raise any objection to the acquisition. Therefore, that part of the acquisition does not, as such, raise any further state aid issues to be addressed in the present case.

Use of funds

9. As far as relevant for the present case, LCR were to raise the funds necessary for the construction of the CTRL through a combination of;
   (i) bank debts in respect of Section 1
   (ii) Government guaranteed bonds and (possibly) direct Government funding
   (iii) the purchase proceeds of Section 1 from RTUK, and
   (iv) the Deferred Grant.

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4 Network Rail is a new company that has acquired Railtrack plc from Railtrack Group and which will succeed Railtrack plc as the infrastructure manager of the main rail infrastructure network in Great Britain (see also Commission decision of 17 July 2002, case No N 356/2002).
10. Railtrack Group guarantees the bank debts in respect of Section 1. Considering that the latter will no longer participate in the CTRL project, LCR will release the Group from the guarantees by either (i) replacing the guarantees with a security to existing lenders over the initial instalments of the Deferred Grant or (ii) by repaying the existing debts out of existing funds that it holds on deposit and/or out of the proceeds of the next issue of Government Guaranteed Bonds.

**Deferred Grant**

11. Under the existing scheme it is envisaged that the Deferred Grant would be applied for the construction of Section 2. However, due to Railtrack Group’s withdrawal from the CTRL project it is considered necessary to amend the conditions attached to the Deferred Grant in a way as to permit LCR to use it to secure existing financing of Section 1 and for additional financing needs.

12. Currently, the first instalment of the Deferred grant is payable on the later of 46 months after the raising of finance for the completion of Section 2 or on 14 February 2005. In order to allow the holders of the Deferred Grant security to have certainty, the UK Government will remove the 46 month condition so that the first instalment of the Deferred Grant will be payable on 14 February 2005. In addition, some conditions may be amended as to ensure the payment of the grant instalments in the event of a termination of the Development Agreement. This includes the possibility of a direct agreement between the Government and the lenders that the instalments may be paid directly to the lenders in case of default by LCR and/or its subsidiaries.

**Government Guaranteed Bonds**

13. Furthermore, the purchase of RTUK itself will be funded by LCR by using part of the £ 1.1 billion of proceeds to be raised from Government Guaranteed Bonds. Considering that the proceeds from these bonds, under the existing system, are envisaged to fund the construction of Section 2, the conditions attached to the Bonds have to be modified as to allow LCR to use these proceeds to purchase RTUK. In addition, the conditions will also be amended as to allow LCR, as an alternative to the option described in the above paragraph, to use these proceeds to repay the existing debts that are currently guaranteed by Railtrack Group.

14. It follows that LCR will apply the Deferred Grant and part of the proceeds deriving from the Government Guaranteed Bonds, which both are notionally intended for the construction of Section 2, for the purpose of acquiring RTUK and to secure existing and additional financing for the construction of the Channel Tunnel Rail Link, including financing for Section 1.

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6 According to the existing financing arrangements Railtrack Group would act as a guarantor in respect of up to £ 700 million of borrowings by LCR for the construction of Section 1.
Table 2: Summary of public support following the 2002 restructuring

<table>
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<tr>
<th>Public support measure</th>
<th>Amount of aid</th>
<th>Beneficiary</th>
<th>Changes by 2002 notification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital grant</td>
<td>£555 million</td>
<td>LCR</td>
<td>No changes.</td>
</tr>
<tr>
<td>Deferred grant</td>
<td>£1,036 million</td>
<td>LCR</td>
<td>Instalments may be used as security to replace existing Railtrack Group’s guarantees for borrowings used to finance construction of Section 1 and for raising additional finance (earlier than previously envisaged). Possibility for a direct agreement between the UK Government and the lenders and changes to conditions attached to payments.</td>
</tr>
<tr>
<td>Domestic Capacity Charges (DCC)</td>
<td>£416 million</td>
<td>LCR</td>
<td>LCR (as a result of the acquisition of RTUK) will be the beneficiary in respect of Section 1 as well as section 2.</td>
</tr>
<tr>
<td>Government guaranteed bonds</td>
<td>£3.75 billion (nominal value)</td>
<td>LCR and/or the final infrastructure manager of CTRL</td>
<td>Use of part of proceeds of £1.1 billion of Government Guaranteed Bonds to finance the acquisition of RTUK and possibly to repay existing debts guaranteed by Railtrack Group.</td>
</tr>
<tr>
<td>Track access charge guarantee</td>
<td>n/a</td>
<td>LCR</td>
<td>LCR (as a result of the acquisition of RTUK) will be the beneficiary in respect of Section 1 as well as section 2.</td>
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<tr>
<td>Track Access Charge support (TAC)</td>
<td>up to £184 million</td>
<td>EUKL and/or the final infrastructure manager of CTRL</td>
<td>No changes.</td>
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<tr>
<td>Stamp duty</td>
<td>£120 million</td>
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<td>No longer expected to be required</td>
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<td>£13 million, unlimited Government exposure</td>
<td>LCR</td>
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</table>

Assessment of the notified alterations/modification
15. In its previous decisions\(^7\), the Commission concluded that the UK Government support for the CTRL project did either not constitute state aid or was exempted by virtue of Article 87.3 (b) of the Treaty with regard to aid for the infrastructure owner/manager and Article 3.1 (b) of Regulation 1107/70 in respect of aid for the train operator (EUKL).

16. The existing public support mechanisms in favour of the CTRL project were put in place against a background whereby RTUK, as a subsidiary of Railtrack Group, was committed to purchase Section 1 from LCR upon completion and where parts of LCR’s overall financing requirements for the construction of the CTRL were to be financed through RTUK’s purchase of Section 1. The present notification therefore relates to the modifications/amendments to the financial support made available to the infrastructure owner/manager of the CTRL, which have been brought about as a consequence of the fact that LCR will purchase RTUK from Railtrack Group. These modifications do however not provide any additional public support but do in some cases change the identity of the beneficiary of certain public support and the form and/or conditions under which the financial support will be provided.

17. The Commission notes in particular that following LCR’s purchase of RTUK and the rights the latter held in Section 1, LCR will become the sole beneficiary of the Domestic Capacity Charges (DCC) and the Track Access Charge Guarantee. It also notes that certain modifications have been called for in respect of the Deferred Grant and the use of the proceeds from the Government Guaranteed Bonds.

18. In its earlier decisions the Commission has considered that these measures, which will be affected by the 2002 restructuring, are necessary for the promotion of a concrete, specific and well defined project of common European interest that is deemed important, quantitatively as well as qualitatively. Consequently, the Commission has deemed these measures compatible with the Treaty by virtue of Article 87.3 (b) of the Treaty.

19. The notified modifications do not alter this assessment. The Commission considers that the 2002 restructuring of the CTRL project is consistent with and preserves the essential financial arrangements that has already been approved by the Commission. It is in particular noted that the modifications/amendments, which are consequential to Railtrack Group’s decision to dispose of its interests in the CTRL, ensure the continued private partner participation in the construction of the CTRL and will facilitate the raising of private funds for the construction of the Link in its entirety.

20. The Commission takes also note of the fact that its decision of 24 April 2002\(^8\) cleared that certain conditions relating to the Deferred Grant may be amended as to provide greater certainty to LCR’s financiers that the instalments would be paid. The purpose of these foreseen amendments were to protect lenders, possibly by way of a direct agreement with the Government, and to ensure that payment of

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\(^7\) Cases N 234/96 (Commission decision of 22.5.1996); N 576/98 (Commission decision of 18.1.1999); N 706/2001 (Commission decision of 24.4.2002).

\(^8\) Case no N 706/2001
the grant instalments would survive termination of the Development Agreement and/or Section 1 concession. The modifications now notified are in line with the envisaged modifications already approved by the Commission in the aforementioned decision.

21. In view of the above and in line with its conclusions in its earlier decisions concerning financial support for the CTRL project, the Commission finds that the modification made to the public support made available to the infrastructure owner/manager of the CTRL under the 2002 restructuring are deemed compatible with the common market by virtue of Article 87.3 b) of the Treaty.

Decision.

The Commission has accordingly decided:

- to consider the notified amendments/modifications for the CTRL project to be compatible with the EC Treaty and not to raise any objections.

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Yours faithfully,

For the Commission

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