

# 4 Eurotunnel

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## History and current activities

### *History*

4.1. In April 1985 the British and French Governments invited proposals to build and operate a fixed link across the Channel financed wholly by private capital. In January 1986 the two Governments chose the scheme submitted by the Channel Tunnel Group and France Manche, two consortia, one British and one French, together comprising ten contractors and five banks,<sup>1</sup> for construction of twin railway tunnels from Cheriton, near Folkestone, to Coquelles, near Calais. In February of that year they signed a treaty authorizing a fixed link between the two countries.

4.2. In March 1986 the British and French Governments granted a concession giving the right to develop, finance and operate the Tunnel to The Channel Tunnel Group Limited and France Manche SA. Shortly thereafter Eurotunnel Plc and Eurotunnel SA were established as the holding companies of The Channel Tunnel Group Limited and France Manche SA respectively and other subsidiaries, together forming the Eurotunnel Group (Eurotunnel) controlled initially by the member companies of the two consortia. The Anglo-French Treaty (the Treaty) was ratified on 29 July 1987, and on the same day the concession entered into force for a period ending in 2042 (subsequently extended to 2052 by agreement signed in December 1993). Eurotunnel is required to put forward by 2000 a proposal for a 'drive-through link' to be added when technical and economic conditions permit. The Governments have agreed not to facilitate a second link built by others to open before 2020, but remain free to issue an invitation for a second fixed link to be built by others if there is not agreement by 2010 on a second link to be built by Eurotunnel.

4.3. Under the concession the Channel Tunnel Group and France Manche agreed to ensure the steady flow and continuity of traffic through the fixed link system and to ensure that traffic may pass through

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<sup>1</sup>National Westminster Bank PLC, Midland Bank PLC, Cr dit Lyonnais, Banque National de Paris and Banque Indosuez.

the system with reasonable safety and convenience. The two Governments agreed to ensure that Eurotunnel is free, subject to national and European competition laws, to establish and carry out its own commercial policy with respect to pricing and the type of service to be offered. The two Governments also agreed to consider with Eurotunnel any changes in tax or customs law which appeared to have a discriminatory effect and not to intervene in the conduct or operation of the fixed link, save on grounds of national defence or in the event of failure by Eurotunnel to comply with the concession.

4.4. After the award of the concession, the ten contractors forming Transmanche Link entered into the contract to design, build, procure and commission the Tunnel and the transportation system. The contract with Eurotunnel was signed in August 1986. The five banks then led the underwriting and syndication of the secured bank facilities for the project. Eurotunnel itself retained responsibility for managing the construction contract, planning the operational phase, and managing the system once operational. The main construction work on the Tunnel started at the end of 1987.

#### *The Intergovernmental Commission and the Safety Authority*

4.5. The IGC, whose members are nominated in equal numbers by the two Governments, was established under the Treaty to supervise, on behalf of the Governments, all matters concerning the construction and operation of the fixed link. The Safety Authority, whose members are drawn from the national bodies with responsibility for safety, or with relevant expertise, was established under the Treaty to advise and assist the IGC on all matters concerning safety in the construction and operation of the fixed link.

#### *The Eurotunnel system*

4.6. The Eurotunnel system incorporates:

- twin rail tunnels approximately 50 kilometres long, used both by shuttles and through trains, and a service tunnel, linked to the main tunnels by cross-passages at about every 375 metres;
- terminals, near Folkestone in the UK and at Coquelles near Calais in France, with connection to national road and rail networks;
- specially designed shuttles, which carry passenger and freight vehicles between the terminals; and
- clearance depots for freight adjacent to the French terminal and at Ashford near the UK terminal allowing the passage of through-passenger and through-freight trains operated by the national railway companies (the Railways).

4.7. The Tunnel carries four main types of traffic:

- (a) cars and coaches in passenger shuttles (Le Shuttle-Tourist), operated by Eurotunnel;
- (b) heavy goods vehicles in freight shuttles (Le Shuttle-Freight), operated by Eurotunnel;
- (c) Eurostar through-passenger trains, operated by the Railways; and
- (d) through-freight trains, operated by the Railways.

4.8. Eurotunnel told us that it currently had no plans to carry unaccompanied freight. It is, however, technically feasible for it to do so.

## *The Railway Usage Contract*

4.9. The Railway Usage Contract (the RUC) was entered into on 29 July 1987 by Eurotunnel, British Rail and SNCF (the French national railway); British Rail's rights and obligations will be transferred to the private sector as part of privatization. The RUC sets out the basis on which the Railways will use the Tunnel for the whole of the concession period. Under the RUC, the Railways are entitled to up to 50 per cent of the capacity of the Tunnel an hour in each direction.

4.10. The Railways are obliged under the RUC to pay usage charges to Eurotunnel. The usage charges comprise a fixed annual amount and a variable element made up of tolls calculated by reference to number of passengers and tonnes of freight; there are specified minimum payments during the first 12 years after the commencement of full operations. In addition, the Railways pay a proportion of the operating and maintenance costs of the Tunnel.

4.11. The Tunnel first opened to traffic in 1994, initially for freight services. In late 1994 the first passenger services began (via Le Shuttle and Eurostar). During 1995 Le Shuttle services were progressively extended to all types of vehicles, opening to coaches in June, bicycles and motor cycles in August and caravans in September. By the end of 1995 the tunnel was fully open to all traffic except for certain excluded categories of freight referred to in paragraphs 5.75 and 5.76.

### ***Eurotunnel's traffic and revenue forecasts***

4.12. Since 1985 Eurotunnel has retained independent traffic and revenue consultants (TRC), who are responsible for preparing traffic and revenue projections, on behalf of Eurotunnel and the banks, taking into account the latest available information on traffic levels and other variables. The most recent traffic and revenue forecasts were produced in December 1995.

4.13. Table 4.1 sets out the December 1995 traffic forecasts for Le Shuttle-Freight and Tourist for 1996 to 1998. 1996 forecasts have been included for comparison with actual volumes of traffic in 1996 (discussed in paragraph 4.18).

TABLE 4.1 **Le Shuttle: forecast vehicle traffic, 1996 to 1998**

	<i>'000 vehicles</i>		
	<i>1996</i>	<i>1997</i>	<i>1998</i>
Le Shuttle-Tourist (car)	[ <i>Figures omitted.</i>		
Le Shuttle-Tourist (coach)	<i>See note on page iv.</i>		
Le Shuttle-Freight	]		

*Source:* Eurotunnel.

4.14. Table 4.2 shows the estimated Eurotunnel revenues for 1996 to 1998. Revenues include:

- (a) turnover from the Le Shuttle-Freight and Tourist services; and
- (b) tolls, usage charges and contribution to costs received from the Railways.

TABLE 4.2 Eurotunnel: forecast revenues, 1996 to 1998

	<i>£ million*</i>		
	1996	1997	1998
Le Shuttle-Tourist (car)	[		
Le Shuttle-Tourist (coach)			
Le Shuttle-Freight			
Ancillary revenues:			
Le Shuttle retail sales#			
Other non-traffic-related sales (sponsorship, advertising, telecommunications, exhibition centres)		<i>Figures omitted. See note on page iv.</i>	
Railways (tolls, minimum usage charges and contribution to costs)~			
Less unit-holders' travel entitlements			]

Source: Eurotunnel.

\*All figures stated in 1995 prices.

#Includes retail sales at Le Shuttle terminals and catering sales on board Le Shuttle trains. Figures stated net of cost of sales.

~ During the first 12 years of the Tunnel's operation, income from the Railways is subject to a minimum usage charge and is expected to remain static throughout this period.

### ***Current activities***

4.15. Since the Tunnel first opened in 1994, traffic volumes have grown significantly, affected only by the Tunnel fire (discussed in paragraph 4.19) in November 1996.

4.16. Table 4.3 shows the number of trains using the Tunnel in 1995 and 1996.

TABLE 4.3 The Channel Tunnel: trains using the Tunnel, 1995 and 1996

	<i>number of trains</i>	
	1995	1996
Le Shuttle-Freight	29,863	32,264
Le Shuttle-Tourist	26,687	36,045
Railways-Railfreight	5,289	7,189
Railways-Eurostar	8,196	13,677

Source: Eurotunnel.

4.17. Table 4.4 shows the total volume of traffic using the Tunnel in 1995 and 1996.

TABLE 4.4 The Channel Tunnel: volumes of traffic, 1995 and 1996

	1995	1996
<i>Le Shuttle-Freight</i>		
Freight units carried	390,775	519,003
<i>Le Shuttle-Tourist</i>		
Cars carried	1,222,713	2,076,954
Coaches carried	23,383	57,962
Passengers carried	4,869,143	8,806,806
<i>Railways-Railfreight</i>		
Tonnes carried	1,349,802	2,360,906
<i>Railways-Eurostar</i>		
Passengers carried	2,920,309	4,866,566

Source: Eurotunnel.

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4.18. The number of cars actually carried by Le Shuttle-Tourist in 1996, at 2,076,900 vehicles, exceeded the 1996 forecast by around 10 per cent (1,895,600 vehicles in Table 4.1). The number of coaches actually carried in 1996, at 58,000 vehicles, was 20 per cent below the forecast (72,500 vehicles in Table 4.1). The number of freight units actually carried by Le Shuttle-Freight in 1996, at 519,000 units, was 16 per cent below forecast (620,800 in Table 4.1).

### *The Tunnel fire*

4.19. On 18 November 1996 a fire occurred on a Le Shuttle-Freight train while it was travelling through the Tunnel causing considerable damage to the train involved, the tunnel and the track. Following the fire the Tunnel was initially closed to all traffic. Through-freight trains recommenced on 21 November, Eurostar services on 4 December and Le Shuttle-Tourist services on 10 December. At the end of March 1997, a section of the Tunnel remained closed and Le Shuttle-Freight services continued to be suspended.

4.20. Eurotunnel told us that the future of Le Shuttle-Freight services depended on the outcome of three inquiries. First, as the incident took place in a part of the Tunnel covered by French jurisdiction, a judicial inquiry into the causes of the fire was being carried out by an examining judge in France. Eurotunnel told us that it did not know when the examining judge would announce a decision but meanwhile the Le Shuttle rolling stock involved in the fire was held under seal and had not been retrieved or tested by Eurotunnel. Secondly, the Safety Authority was carrying out an inquiry, which would take about three months but could not make progress until it received the results of the third inquiry, being carried out by Eurotunnel itself.

4.21. Eurotunnel's own inquiry is concerned with the circumstances of the fire itself and how the relevant equipment and employees reacted. Eurotunnel told us that when its inquiry was completed it would present a full report to the IGC and the Safety Authority together with proposals for the resumption of Le Shuttle-Freight services.<sup>1</sup> Eurotunnel hoped soon to agree with the IGC and Safety Authority the operational conditions for the resumption of Le Shuttle-Freight services and to have the necessary repairs to the closed part of the Tunnel completed by the end of May 1997.

4.22. Eurotunnel expected to regain, by the end of 1997, the level of activity which it would have achieved had its growth not been interrupted by the fire. Eurotunnel told us that although the loss attributable to the fire (including repair work, lost revenues and third party claims) was substantial, it expected that the direct impact of the fire on its own financial position would be limited to around £7 million. Most of the losses (including lost revenue while Le Shuttle-Freight services were suspended) would be covered by insurance.

4.23. We asked Eurotunnel about the implications for it of any additional safety measures which might be required as a result of the current inquiries. Eurotunnel told us that if it were unable to get the agreement of the IGC to continue with the semi-open freight shuttle the consequences would be 'disastrous' and would probably derail the financial restructuring plans discussed in paragraphs 4.36 to 4.39.

### *Capacity*

4.24. Le Shuttle's capacity is partly a function of the Tunnel's capacity, partly of the amount and capacity of rolling stock and partly of the capacity of the infrastructure for handling and loading traffic.

4.25. The capacity of the Tunnel itself is measured in 'train paths' an hour where a path is a measure of potential throughput taking into account speed and length of trains used (for example, a Eurostar train occupies 1.85 paths when crossing in flights of two at 160 kph).

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<sup>1</sup>Eurotunnel's report into the fire was published on 3 April 1997.

4.26. Immediately before the fire, the Tunnel was being used to the extent of nine train paths an hour in each direction against the existing authorized limit of 12 paths an hour. The current theoretical limit is 20 paths an hour but this could be raised to 24 paths by investment in new signalling and to 30 paths by longer-term development of the technology required to allow trains to run only 2 minutes apart against the current minimum of 3 minutes.

4.27. These paths are shared equally between, on the one hand, Le Shuttle and, on the other hand, various railway companies which use the Tunnel. Eurotunnel can decide how to use the paths allocated to Le Shuttle. Before the fire, they were shared broadly equally between the passenger and freight shuttles but the mix can be varied to allow for peaks and troughs in the two markets.

4.28. The nominal carrying capacity of Le Shuttle-Tourist services operated in 1996 was 6,920,640 PCUs (see glossary); and the nominal capacity of Le Shuttle-Freight services was the equivalent of 4,516,960 PCUs. However, the amount of this capacity which can be used in practice is limited by two factors: the difficulty of filling capacity offered by a regular schedule at off-peak periods; and loading constraints in peak periods. The loading constraints arise from congestion in the 'allocation areas' at Eurotunnel's terminals and cannot be solved simply by operating additional shuttles or adding more rolling stock.

4.29. Eurotunnel estimates that, because of the combination of congestion problems at peak times and under-use of capacity at other times, the highest capacity utilization (or 'load factor') it could expect to achieve in the peak months of August (for passengers) and November (for freight) would be 67 per cent. The effect of generating peak-time demand which would allow this figure to be exceeded would be to introduce delays to users which Eurotunnel regards as beyond the acceptable maximum (more than 60 minutes for 5 per cent of passengers or for 2.5 per cent of freight traffic).

4.30. The limitation on load factor in the peak months means that load factors over a year are lower, significantly so in the case of passenger traffic where capacity utilization falls away sharply at certain times of the year. The overall load factor in 1996 was 34 per cent for Le Shuttle-Tourist and 57 per cent for Le Shuttle-Freight. However, Eurotunnel is trying to deal with the problem of congestion by the greater use of reservation arrangements to spread demand to less busy times. Taking this into account, Le Shuttle-Tourist is expected to achieve an overall load factor of 51 per cent by 1998 increasing eventually to 60 per cent. Le Shuttle-Freight's load factor is expected to reach 63 per cent in the period to 1998 and to rise slightly further, to 64 per cent, in the longer term.

4.31. All Eurotunnel's market share forecasts, including the original forecast of a 70 per cent market share for passenger vehicle traffic contained in the company's prospectus, take all these capacity constraints into account.

### ***Ownership and financial structure***

4.32. A public issue of shares on a 'twinned' basis (one unit in Eurotunnel comprises one share in Eurotunnel PLC and one share in Eurotunnel SA) was made in November 1987. Subscribers to the initial public issue of shares and to the 1990 rights issue obtained certain rights to concessionary fares. Since November 1987, Eurotunnel units have been listed on the London Stock Exchange, the Paris Bourse and the Brussels Stock Exchange, with the exception of the period between 30 September 1996 and 7 October 1996 when dealings in units were suspended in order to avoid a false market and prevent speculation pending finalization of the restructuring agreement with banks.

4.33. The financing arranged by Eurotunnel up to December 1987, comprising £5,000 million of credit facilities and £1,023 million of equity, proved insufficient to meet the forecast costs of the project, and in 1990 Eurotunnel arranged for additional credit facilities of £2,100 million and a Rights Issue to raise £566 million. In 1994, following a delay in opening the Tunnel and further increases in construction costs, Eurotunnel arranged for additional credit facilities of £647 million, with an offer of an additional facility of £50 million, and a further Rights Issue to raise £754 million.

4.34. At 31 December 1994 loans drawn down under the credit agreements and accrued interest amounted to around £8.0 billion.

4.35. During 1994 Eurotunnel obtained further commitments of around £730 million from a group of banks on a senior secured basis. Around £260 million of these commitments were drawn down in 1995.

4.36. In September 1995 Eurotunnel announced that it was suspending payment on its junior debt (which amounted at that stage to around £8.7 billion) under the standstill provision of its credit agreements.<sup>1</sup> The standstill provisions allowed for interest payments to be suspended for a period of up to 18 months while a financial restructuring plan was negotiated and agreed with the banks and the necessary shareholder approvals obtained.

4.37. Eurotunnel told us that the decision to suspend interest payments was reached because the then financial projections indicated that there was a possibility that the rolled-up interest would continue to accrue at a rate which would mean Eurotunnel would never be able to repay the capital sum.

4.38. In October 1996 Eurotunnel announced that it had reached agreement with its banking syndicate on the outline of a restructuring plan. The main elements of the restructuring plan were:

- (a) To reduce the level of outstanding junior debt by £1.0 billion via a debt/equity swap. A further £3.7 billion of junior debt will be converted into new instruments to be created as part of the restructuring plan.
- (b) To fix interest rates on the junior debt and new instruments for seven years at levels below market rates.<sup>2</sup>
- (c) To allow interest which cannot be paid in cash when due to be settled with notes which do not bear interest for the next nine years.
- (d) To extend the maturity profile of Eurotunnel's debt.

4.39. Eurotunnel told us that it had intended to obtain the necessary banking syndicate vote and shareholder approvals for the restructuring plan by the spring of 1997. This timetable would have coincided with the end of the 18-month period allowed by the standstill provisions. However, in view of the Tunnel fire, Eurotunnel judged it inappropriate to proceed with the proposals for the restructuring plan, until the Tunnel and Le Shuttle's services were back in full operation. On 20 January 1997 Eurotunnel announced that it would be deferring the process to obtain shareholder approval until June 1997. On 24 February 1997 Eurotunnel announced that representatives of its banking syndicate had agreed to extend the standstill provisionally until December 1997.

## Financial performance

4.40. Eurotunnel prepares accounts for Eurotunnel Plc and Eurotunnel SA on a combined basis. Table 4.5 summarizes the financial performance of Eurotunnel for the three years since the Tunnel opened. The 1996 figures shown are provisional and have yet to be finalized.

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<sup>1</sup>The credit agreements govern the relations between Eurotunnel and its 225 lending banks. These banks are separated into three categories: four agent banks which are responsible for the day-to-day management of the loans; 24 instructing banks (including the four agent banks) which form a small group responsible for approving certain decisions; and finally the syndicate banks which vote the main decisions.

<sup>2</sup>The restructuring plan results in an average fixed interest rate of 5.2 per cent a year payable annually in arrears until December 2003 on loans totalling £7.7 billion.

TABLE 4.5 Eurotunnel: combined profit and loss account

	<i>£ million</i>		
	<i>Years ended 31 December</i>		
	<i>1994</i>	<i>1995</i>	<i>1996</i> <i>(provisional)</i>
<i>Turnover, other operating income and capitalized expenditure</i>			
Turnover and other operating income	30.6	298.6	448.1
Own work capitalized*	715.8	-	-
Deferred expenses and recharges	<u>51.5</u>	<u>5.3</u>	<u>-</u>
	<u>797.9</u>	<u>303.9</u>	<u>448.1</u>
<i>Operating expenditure</i>			
Materials, services and staff costs	320.2	307.8	386.4
Bank fees and expenses	81.4	59.8	#
Depreciation	38.8	130.4	#
Provisions and other charges	<u>107.1</u>	<u>6.3</u>	<u>#</u>
	<u>(547.5)</u>	<u>(504.3)</u>	<u>#</u>
Income from investments	10.5	4.8	#
Profit/(loss) before interest and exchange differences	260.9	(195.6)	#
Interest	(642.9)	(759.9)	#
Exchange differences	(4.9)	30.6	#
(Loss) for the year	(386.9)	(924.9)	#

Source: Eurotunnel.

\*During the construction of the Tunnel all costs and revenues arising either directly or indirectly from the design, financing and construction of the Tunnel were capitalized. Certain of these costs, primarily financing, are taken to the profit and loss account and then capitalized.

#Figures are not available.

4.41. Eurotunnel told us that it had been set cash targets by its bankers and that its short-term aim was to generate surplus cash over its cash operating expenditure (that is, operating expenditure before bank fees and expenses, depreciation and provisions and other charges). Table 4.5 shows that in 1996 Eurotunnel generated excess revenues of £61.7 million over its cash operating expenditure.

4.42. Eurotunnel told us that over the next ten years it aimed to cover progressively all its operating expenditure (that is, including depreciation) and its financing costs so that by 2007 it expected to be in a position to pay a small dividend to its unit holders.

4.43. Table 4.6 summarizes Eurotunnel's combined balance sheet for 31 December 1994 and 1995.

TABLE 4.6 Eurotunnel: combined balance sheet

	<i>£ million</i>	
	<i>At 31 December</i>	
	<i>1994</i>	<i>1995</i>
<i>Fixed assets</i>		
Concession fixed assets	9,452.9	9,395.2
Other fixed assets (including investments)	<u>8.3</u>	<u>4.7</u>
	<u>9,461.2</u>	<u>9,399.9</u>
Net current assets/(liabilities) (excluding net borrowings)	<u>2.9</u>	<u>(114.5)</u>
	9,464.1	9,285.4
Net borrowings*	(7,720.8)	(8,804.3)
Provisions for liabilities and charges	<u>(3.5)</u>	<u>(14.6)</u>
Shareholders' funds	1,739.8	466.5

Source: Eurotunnel.

\*Net of investments and liquid funds.

4.44. The concession fixed assets referred to in Table 4.6 comprise the tunnels and the equipment required to operate the infrastructure of the Tunnel and the terminals and rolling stock used by Le Shuttle.

4.45. Table 4.7 shows the cost and net book value of the concession fixed assets at 31 December 1995.

TABLE 4.7 Eurotunnel: net book value of concession fixed assets, 31 December 1995

	<i>£ million</i>	
	<i>Cost</i>	<i>Net book value</i>
Tunnel infrastructure:		
Tunnels	4,494.6	4,485.9
Fixed equipment	2,295.5	2,218.6
Other fixed assets	<u>242.4</u>	<u>194.1</u>
	7,032.5	6,898.6
Fixed assets used principally by Le Shuttle operation:		
Rolling stock	1,259.8	1,205.5
Terminals and related land*	<u>1,300.6</u>	<u>1,291.1</u>
	2,560.4	2,496.6
Total concession fixed assets	9,592.9	9,395.2

Source: Eurotunnel.

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\*Terminals and related land allocated 90 per cent to Le Shuttle.

4.46. Eurotunnel's combined accounts are subject to annual audit. The most recent published accounts for Eurotunnel are those for the year ended 31 December 1995. The auditors' report contained an explanatory paragraph about the going concern basis on which the accounts had been prepared. The auditors' report referred to three uncertainties surrounding the ability of Eurotunnel to continue trading. These were:

- (a) the possibility that a qualifying majority of the banks would terminate the standstill period. The banks could then initiate the exercise of their security, including their right of substitution;<sup>1</sup>
- (b) the possibility of failure of negotiations with the banks, or the rejection by shareholders of a restructuring plan, which would result in the need to reduce the value of the assets to their recoverable amounts; and
- (c) in the case of a successful outcome of the negotiations, the possibility that the book value of certain assets and liabilities would need to be adjusted.

A similar statement was made by the auditors in their report on the accounts for the half year ended 30 June 1996 (published in September 1996).

## **Profitability of Le Shuttle and the Railways**

4.47. We asked Eurotunnel to provide us with information about the profitability of the Le Shuttle and Railways parts of its business.

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<sup>1</sup>Substitution is a process whereby the banks may under certain conditions and subject to the consent of the Governments of France and the UK have the concession, its rights and obligations transferred to companies owned by them until such time as the Group's obligations to the banks have been satisfied.

4.48. Table 4.8 summarizes the financial performance for Le Shuttle and the Railways for 1995 and 1996. Further details of revenues and costs are provided in Appendix 4.1.

TABLE 4.8 Eurotunnel: summary of financial performance of Le Shuttle and Railways, 1995 and 1996

		<i>£ million</i>	
		<i>Years ended 31 December</i>	
		<i>1995</i>	<i>1996</i>
<i>Turnover</i>			
Le Shuttle*	[		
Railways			
<i>Materials, services and staff costs</i>			
Le Shuttle			
Railways			
<i>Profit/(loss) before depreciation, provisions and financing charges</i>			
Le Shuttle		<i>Figures omitted.</i>	
Railways		<i>See note on page iv.</i>	
<i>Depreciation</i>			
Le Shuttle			
Railways			
<i>Profit/(loss) before provisions and financing charges</i>			
Le Shuttle			
Railways			]

Source: Eurotunnel.

\*Turnover figures are stated net of cost of sales of duty-free and other ancillary sales (1995-£19.3 million, 1996-£49.7 million).

4.49. Table 4.8 shows that the Le Shuttle part of Eurotunnel's business has yet to meet its short-term aim of generating sufficient revenues to meet its cash operating expenditure (that is, before depreciation and other charges).

4.50. Actual revenues from the Railways in 1996 (£198.2 million) were broadly in line with the forecasts made in December 1995 (£206.2 million-see Table 4.2).

4.51. Table 4.9 compares 1996 actual Le Shuttle revenues with forecast. Despite the increase in passenger car traffic referred to in paragraph 4.18, ticket revenues from passenger cars were around 30 per cent short of the forecast, largely reflecting Le Shuttle's May 1996 fare cuts. Coach and freight revenues were also short of forecast levels (by 40 per cent and 32 per cent respectively). Revenues from retail and catering sales were, however, around 80 per cent higher than forecast.

TABLE 4.9 **Le Shuttle 1996 revenues: actual and forecast**

	<i>£ million</i>	
	<i>1996 forecast</i>	<i>1996 actual</i>
Ticket revenue-cars	[	68.4
Ticket revenue-coaches		7.4
Retail and catering sales (net)*	#	55.4
Freight		<u>68.9</u>
	]	200.1

Source: Le Shuttle.

\*Net of product cost of sales.

## Le Shuttle operating costs

4.52. Eurotunnel told us that the two parts of its business (Le Shuttle and the Railways) were ring-fenced. The pricing decisions of Le Shuttle and its financial targets (that is, to generate cash in excess of operating expenditure) were unaffected by the financial performance of the Railways part of the business.

4.53. The operations of Le Shuttle are different from those of the ferry operators. Le Shuttle does not require a port harbour to provide 'berthing' (instead it owns and operates its own terminals). Sales of duty-free and other products largely occur at terminals at either end of the Tunnel rather than on board the train. The Shuttle service shares the operating costs of running the Tunnel (including Tunnel maintenance, power, operational staff and insurance) as well as incurring its own directly attributable costs.

4.54. Eurotunnel provided us with analyses for 1995 and 1996 of its operating costs (before financing) divided into four categories (variable costs, semi-variable costs, overheads, and start-up/exceptional costs). Eurotunnel told us that it did not normally analyse its costs in this way. The analyses were intended solely to facilitate comparison with the ferries.

4.55. We identified Le Shuttle's operating costs as:

- (a) variable costs (in Le Shuttle's case these are solely the costs of travel agents' commissions). Le Shuttle does not incur port tolls in the same way that the ferry companies do. Its nearest equivalent costs are its terminal costs which we categorized as a semi-variable cost (see (b));
- (b) semi-variable costs including fuel, shuttle crew costs, retail commercial (costs of staff selling retail products), terminal costs (includes rates, maintenance and security costs at terminals), maintenance costs on rolling stock, depreciation on rolling stock and Le Shuttle's share of the Tunnel's operating costs (tunnel maintenance, power, operational staff and insurance);
- (c) marketing and administration costs; and
- (d) start-up and exceptional costs include refinancing fees and bank relations. Eurotunnel told us that these costs were largely non-recurring in nature.

Details of the above costs are provided in Appendix 4.1.

4.56. Le Shuttle's total operating costs (before financing) (including depreciation on rolling stock and the Tunnel) amounted to £377.9 million in 1996. Leaving out start-up costs of £60.8 million (on the basis that these are non-recurring) and depreciation on the Tunnel of £50.8 million (on the basis that this is a 'sunk' cost) total operating costs would be £266.3 million. Table 4.10 analyses these costs into the variable, semi-variable and overhead components.

TABLE 4.10 **Le Shuttle: 1996 operating costs\***

	£'000
Variable costs	[
Semi-variable costs	
Overheads	#
Depreciation of rolling stock	
Total	]

Source: MMC based on data provided by Eurotunnel.

\*Excluding start-up/exceptional costs, depreciation on the Tunnel and financing costs.

4.57. In 1996 the capacity provided by Le Shuttle (measured in car equivalents) was 11.438 million PCUs (see Table 5.11). During the year Le Shuttle actually carried passenger and freight traffic, equal to 4.962 million PCUs (see Table 5.13), giving a capacity utilization of some 43 per cent.

4.58. We compared the level of Le Shuttle's operating costs in 1996 with the level of capacity (measured in car equivalents) it provided. We calculated the cost of each unit of capacity assuming three different levels of capacity utilization: 40 per cent, 50 per cent and 65 per cent. The results are shown in Table 4.11.

TABLE 4.11 **Le Shuttle: unit cost of capacity**

	£		
	<i>Per cent capacity utilization</i>		
	40	50	65
Variable costs*	1.13	1.13	1.13
Semi-variable costs#	28.47	22.77	17.52
Overheads	18.42	14.74	11.33
Depreciation of rolling stock	<u>10.12</u>	<u>8.10</u>	<u>6.23</u>
Total costs	58.14	46.74	36.21

Source: MMC based on data provided by Eurotunnel.

\*Travel agents' commission.

#Includes payroll costs, terminal costs, fuel and maintenance and a share of Tunnel operating costs.

4.59. For comparative purposes we calculated the average ticket revenue and profit from retail and catering sales (that is, after deduction of product cost of sales) per PCU in 1996. The average ticket revenue was £29.51.<sup>1</sup> Average profit from retail and catering sales per PCU was £11.30.<sup>2</sup>

<sup>1</sup>Car, coach and freight revenues (£144.7 million) divided by PCUs carried in 1996 (4.904 million PCUs).

<sup>2</sup>Average profit per passenger (£6.29) multiplied by the number of passengers per PCU (1.8 passengers).