



National Audit Office

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## **Memorandum**

to the House of Commons  
Committee of Public Accounts

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## **Department for Transport**

# Out-of-court settlement with Eurotunnel

**MAY 2019**

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Department for Transport

# Out-of-court settlement with Eurotunnel

**MAY 2019**

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# Memorandum on the Department for Transport's out-of-court settlement with Eurotunnel

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The National Audit Office study team consisted of:  
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# Introduction

**1** In December 2018, the Department for Transport (the Department) awarded three businesses with contracts to provide additional freight capacity on ferry services between the UK and mainland Europe.<sup>1</sup> This formed part of the government's plans to mitigate the impact on the transport system if the UK left the European Union (EU) without a deal (no deal). The additional freight capacity was intended to allow government to prioritise the flow of critical goods, particularly medicines, into the UK and to enable imports to flow as freely as possible in the event of no deal. The definition and quantities of critical goods were collectively agreed across government by an ad hoc ministerial meeting on borders and prioritisation and included 'category one' goods including medical supplies, veterinary medicines and essential chemicals. The government wanted the additional capacity to be in place for 29 March, the earliest expected date for the UK's departure from the EU.

**2** On 25 January 2019, The Channel Tunnel Group Limited and France-Manche SA who together operate Eurotunnel services (hereafter referred to as Eurotunnel) began legal action against the Department. Eurotunnel challenged the legal basis on which the freight contracts were procured and the underlying legality of the contracts. On 1 March 2019, the Department announced that a £33 million settlement had been reached with Eurotunnel, which ended the legal action.

**3** This memorandum is a follow-up to our publication *The award of contracts for additional freight capacity on ferry services* which covered the original procurement with the ferry companies.<sup>2</sup> This memorandum has been prepared at the request of the Committee of Public Accounts and examines the settlement with Eurotunnel which had yet to be concluded at the time of our previous work. It describes:

- the Department's consideration of the risk of legal challenge ahead of the original procurement (Part One);
- the decision to settle with Eurotunnel (Part Two); and
- Eurotunnel's commitment under the settlement agreement (Part Three).

**4** This memorandum is based on a review of the documents kept by the Department on the settlement agreement with Eurotunnel. We also conducted interviews with officials involved in the agreement and with Eurotunnel.

<sup>1</sup> The three companies are: Bretagne Angleterre Irlande S.A. (Brittany Ferries); DFDS A/S; and Seaborne Freight (UK) Ltd.

<sup>2</sup> National Audit Office, *The award of contracts for additional freight capacity on ferry services*, Memorandum to the House of Commons Committee of Public Accounts, February 2019.

**5** By the end of March 2019, the additional ferry capacity subject to the original procurement, excluding the contracts with Seaborne Freight (UK) Limited that had been cancelled, had become available. The date for the UK to leave the EU under Article 50 was however extended, first to 12 April 2019 and then to 31 October 2019, with the potential for the UK to leave earlier. The Department had responded to the extension to 12 April 2019 by seeking to sell capacity on the open market. On 1 May 2019 the Department announced that it had cancelled the ferry contracts. This decision was taken after the completion of our fieldwork and is outside the scope of this memorandum.

**6** On 24 April 2019, the Department received a formal claim from P&O Ferries Holdings Ltd challenging the Department's settlement with Eurotunnel on the grounds of, amongst others, state aid and breach of procurement law. Given these proceedings are ongoing, the Department's response to this challenge is outside the scope of this memorandum.

**7** A timeline of key events is set out in Appendix One. Our scope and approach are outlined in Appendix Two.

# Part One

## The Department's assessment of legal risk ahead of procuring the ferry freight capacity

1.1 This part outlines:

- why the Department for Transport (the Department) procured additional freight capacity on ferry services;
- the Department's assessment of legal risk when it signed the ferry contracts; and
- the contracts for ferry freight capacity.

1.2 We reported previously on the Department's procurement of additional freight capacity in our memorandum *The award of contracts for additional freight capacity on ferry services*.<sup>3</sup> In this part we review some of the details of that procurement and provide detail about the Department's assessment, at the time of the procurement, of the legal risks it was taking. The latter are relevant to understanding the Department's response to the subsequent challenge from Eurotunnel.

### **Why the Department procured additional freight capacity on ferry services**

1.3 Departments have been preparing for when the UK leaves the European Union (EU). As part of the preparations for the UK leaving the EU with no deal, departments have been considering how to manage potential disruption to the flow of goods across the border. Over the summer of 2018 these preparations were stepped up.

1.4 In September 2018, the Department began to develop options for mitigating disruption to the transport of freight across the short straits if the UK left the EU without a deal.<sup>4</sup> The Department estimated that around 22% of goods travelling between the UK and the EU are transported by lorry on 'roll-on roll-off' (RORO) services through the Port of Dover and the Channel Tunnel. This accounts for 89% of all UK RORO traffic. The Department's assessment indicated that the short straits were "relied on for the movement of time-critical products such as perishable goods, medicines and manufacturing components used in just-in-time supply chains".

3 National Audit Office, *The award of contracts for additional freight capacity on ferry services*, Memorandum to the House of Commons Committee of Public Accounts, February 2019.

4 There are three short strait routes: Dover to Calais and Dover to Dunkirk via ferry routes, and Folkestone to Coquelles via the Channel Tunnel.



**1.5** During autumn 2018, the government updated its planning assumptions on freight crossing the border in the event of a no deal exit. As described in our previous report, *The award of contracts for additional freight capacity on ferry services*, this revised analysis identified that under a reasonable worst-case scenario the normal flow of goods could be reduced by up to 87% across the short straits crossings, with the most severe disruption lasting for up to six months.<sup>5</sup> The previous government estimate had forecast disruption for six weeks.

**1.6** Having considered the revised planning assumptions, the Department began taking the steps needed to procure additional freight capacity to mitigate some of the potential disruption in the event of no deal. Its intention was to “ensure that capacity and flexibility exists for government to prioritise the flow” of critical goods, including human and animal medicines.<sup>6</sup> In November 2018, the Department set itself the following objectives:

- to minimise the negative economic impact on the UK of a no deal on the day after EU Exit (referred to by government as ‘day one no deal’) by creating new UK–EU freight capacity to reach normal flow levels as closely as possible;
- to ensure that capacity and flexibility exist for government to enable the prioritisation of the flow of certain goods if this course of action is considered necessary; and
- to potentially create longer-term resilience for the UK economy by identifying and kick-starting alternatives to the current short straits routes.

### **The Department’s consideration of legal issues in its procurement process**

The Department followed a procurement route that allowed it to agree contracts quickly but carried greater legal risk

**1.7** By October 2018, when it became clear that additional freight capacity was required, the Department was working against challenging deadlines. The Department’s business case was approved at the end of November 2018, following a process of cross-government decision making, reflecting that the capacity was being secured on behalf of government as a whole.<sup>7</sup> The Department wished the freight capacity to be in place by 29 March 2019, four months from the start of procurement. The Department, based on its engagement with the industry, had determined that the lead time required for new services was three to four months.

<sup>5</sup> See footnote 3.

<sup>6</sup> See footnote 3.

<sup>7</sup> We set out the cross-government approvals in the run up to the Department’s procurement in National Audit Office, *The award of contracts for additional freight capacity on ferry services*, Memorandum to the House of Commons Committee of Public Accounts, February 2019.

**1.8** The Department considered that a typical procurement process, even if accelerated, would not be quick enough and would undermine the deliverability of securing additional freight capacity. Typically, such contracts are awarded through a public process, with prior notification of the competition being published. The Department used an exemption under Public Contracts Regulations (2015), which allows for the award of a contract through a “negotiated procedure without prior publication”. This enables procurement to be completed more quickly but can only be used in limited circumstances. The Department relied on an exemption from a public process “for reasons of extreme urgency brought about by events unforeseen by the contracting authority” whereby the time limits for other procurement approaches could not be complied with. This approach carried greater risks of legal challenge than procurement routes where the process is public.

**1.9** Between 16 and 27 November 2018, ahead of starting procurement, the Department approached nine operators under non-disclosure agreements. These operators were issued with an invitation to tender on 30 November 2018 and asked to submit bids by 14 December 2018.<sup>8</sup> The Department’s requirement was for additional ferry freight services outside of the short straits crossings, that would be ready by 29 March 2019, for a term of six months. The Department received three bids and signed contracts on 21 and 22 December 2018.

**1.10** The Department’s procurement took 23 days from its invitation to tender to the signing of contracts. **Figure 1** on pages 10 and 11 compares this against an estimate of the minimum time an accelerated competitive procurement process could take, following public notification of the procurement and according to regulation rules. The figure also shows the Department’s estimate of the minimum lead-in time required by ferry operators.

The accounting officer weighed the risk of legal action against the risk of not securing additional capacity

**1.11** The Department’s accounting officer recognised that the Department was taking forward a “novel and exceptional proposition”. Prior to signing the contracts, the accounting officer completed a formal review of the project against the standards of regularity, propriety, value for money and feasibility expected by Parliament. An accounting officer assessment is intended to ensure that the actions being reviewed meet the standards set out in *Managing Public Money*.<sup>9</sup>

8 The Department initially ran the procurement over the first weekend of December, with a deadline of 3 December 2018. The Department informed us that no compliant bids were received. The Department spoke to the operators and ran a second procurement between 6 and 14 December 2018.

9 HM Treasury, *Managing Public Money*, July 2013 with annexes revised as at March 2018.

**1.12** The accounting officer drew upon relevant professional advice to inform the assessment. Her assessment established that:

- a negotiated process without prior publication carried much greater legal risk than a more typical, but accelerated, procurement process; and
- if a procurement challenge was raised it was likely to be successful. The Department estimated that any legal remedies would most likely be based on the loss of profit had other ferry operators bid for and won a contract, and that these would not exceed £20 million. The Department also identified other potential legal remedies, but these were not quantified.

**1.13** The accounting officer was aware that there were organisations in the market which could raise a challenge and the business case noted there was a high likelihood of a challenge being brought. In October 2018, prior to initiating the procurement, the Department had recognised that there would be a high risk of legal challenge to government intervention, including a risk that Eurotunnel might challenge its approach.

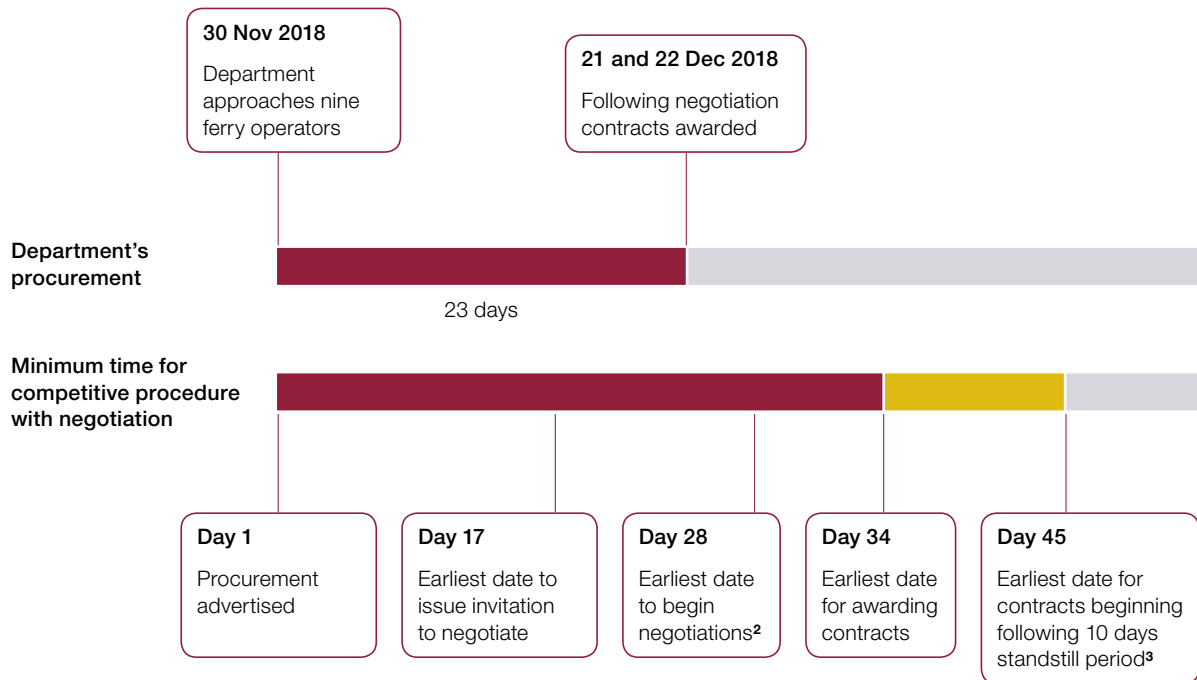
**1.14** The accounting officer was aware that a successful challenge to the procurement could lead to delay or cancellation in the implementation of contracts, and that an alternative remedy to an injunction would be damages. The Department informed us that the accounting officer discussed the timing of a potential challenge with her advisers prior to the procurement decision, and was advised that a trial was unlikely to occur before 29 March 2019.

**1.15** In completing her assessment, the accounting officer needed to decide how to balance the need to act quickly to complete the procurement, so services could be ready by 29 March 2019, against the greater legal risks associated with that course of action. The accounting officer concluded that there were high levels of risk, but that failure to act would lead to government losing the ability to secure freight capacity that would help protect the movement of critical goods including medical supplies. The accounting officer judged that the Department's approach met the standards of regularity, propriety, value for money and feasibility set out in *Managing Public Money*.

**Figure 1**

The Department for Transport's procurement of additional freight capacity on ferry services took 23 days

An alternative procurement approach would have taken a minimum of 45 days, and may not have allowed ferry operators the time to set up services by 29 March 2019<sup>1</sup>

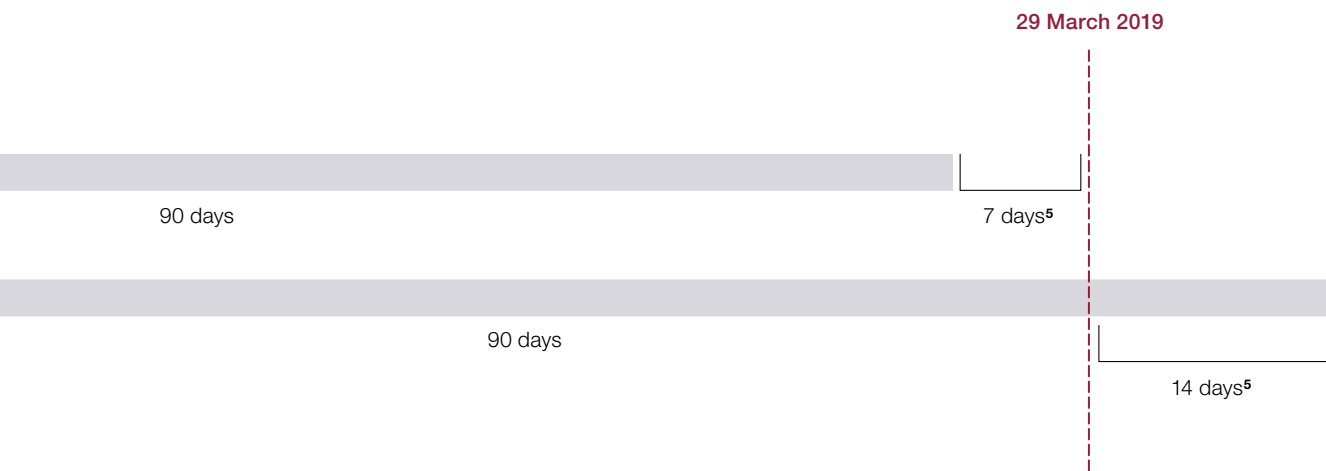


- Procurement and contract award
- Standstill period after contract award
- Department's estimate of the minimum lead-in time required by ferry operators

**Notes**

- 1 The Department estimated, following discussions with the industry, that operators would require between three and four months to put a ferry service in place following the award of a contract.
- 2 There is no minimum period for negotiations set out in regulation. We have used as an estimate the time between the Department's deadline for receiving bids (14 December 2018) and the date the first contract was signed (21 December 2018). This is seven days.
- 3 The standstill period is a required pause between the contract award decision being notified to bidders and the final award of the contract. During this time the decision can be challenged. If no challenge is made the contracts can begin.
- 4 Any 'market testing' by the Department would be carried out prior to 'Day 1' as happened for the Department's chosen procurement route.
- 5 Periods refer to 7 days prior to 29 March 2019 and 14 days after 29 March 2019.

Source: National Audit Office analysis of Department for Transport documents



## Overview of the contracts for ferry freight capacity

**1.16** On 21 and 22 December 2018, the Department awarded three businesses with contracts to provide additional freight capacity on ferry services between the UK and mainland Europe. The total value of these contracts was around £103 million. On 9 February 2019 the Department announced that its agreement with one of the three ferry operators – Seaborne Freight (UK) Limited – had been cancelled. Details of the remaining contracts, with a value of around £89 million, in place at the time the Department agreed its settlement with Eurotunnel are shown in **Figure 2**.

**1.17** At the end of March 2019, the additional ferry capacity became available on schedule. However, at the time of completing our fieldwork the planned date for the UK’s departure from the EU had been extended and the Department was deciding what to do with the capacity it had procured. On 1 May 2019, after the completion of our fieldwork, the Department announced that it had cancelled the remaining ferry contracts with DFDS A/S and Bretagne Angleterre Irlande S.A. (Brittany Ferries). These services had been in operation since 29 March 2019. The cancellation of the contracts is beyond the scope of this memorandum.

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### Figure 2

Overview of the Department for Transport’s contracts with two ferry operators in place at the time the Department agreed its settlement with Eurotunnel

#### On 1 May 2019, the Department announced that it had cancelled these contracts

Contract details <sup>1</sup>	Brittany Ferries	DFDS
Value of contracts <sup>2</sup>	£46.6 million	€47.3 million (£42.1 million) <sup>3</sup>
Number of routes	4	3
Extra capacity provided (additional percentage points compared to normal flows)	3.3 percentage points of which the Department has purchased 83%	3.7 percentage points of which the Department has purchased 100%
Date service must be operational by	29 March 2019	29 March 2019
End of initial period of contract	30 September 2019	30 September 2019
Can contract be extended?	Yes	No
End of possible extension period	29 March 2020	N/A

#### Notes

- Where we refer to ‘Brittany Ferries’ we mean Bretagne Angleterre Irlande S.A. and where we refer to ‘DFDS’ we mean DFDS A/S.
- The value of the contracts is as published by the Department in contract award notices to the *Official Journal of the European Union*. The contract values are exclusive of VAT.
- The Department used an exchange rate of €1:£0.89.

Source: National Audit Office analysis of Department for Transport information

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## Part Two

### The settlement reached with Eurotunnel

**2.1** On 25 January 2019, Eurotunnel began legal proceedings against the Department for Transport (the Department). An initial court hearing took place on 11 February 2019 at which an expedited trial date was set for 1 March 2019. On 28 February 2019 the Department settled with Eurotunnel and agreed to pay it £33 million to end the legal dispute. This part outlines:

- the legal action taken by Eurotunnel;
- the issues the Department considered in responding to the legal action by Eurotunnel; and
- how the Department arrived at a settlement figure of £33 million.

#### **The legal action taken by Eurotunnel**

**2.2** The time limit for challenging public sector procurements is typically 30 calendar days from when an affected party first knew about or ought to have identified an issue. The Department submitted contract award notices to the *Official Journal of the European Union* which were published on 28 December 2018. This was the first point at which businesses which were not invited to take part could have become aware of the procurement.

**2.3** Eurotunnel wrote to the Department on 2 January 2019 outlining its “serious concerns” over the Department’s contracts with the ferry operators. Eurotunnel expressed concern about what it considered to be the distortionary and anti-competitive effects of the contracts. Under the terms of the contracts, for example, the additional services might operate even if an exit deal was reached, which would provide more capacity into the freight market and potentially remove business from Eurotunnel.

**2.4** On 25 January 2019, Eurotunnel began legal action against the Department. Eurotunnel sought, amongst other remedies:

- to have the contracts with DFDS A/S (DFDS) and Bretagne Angleterre Irlande S.A. (Brittany Ferries) declared ineffective (which would cancel prospective obligations under the contracts);
- an award of damages;
- an order imposing civil financial penalties on the Department; and/or
- that the Department carry out a fresh procurement for the supply of additional freight capacity.

**2.5** The Department began discussions with Eurotunnel in early January to understand its position and commercial motives in this case. The Department's rail directorate, who maintain day to day relations with Eurotunnel as a key rail stakeholder, led these discussions. The initial procurement of the ferry freight capacity had been led by the Department's maritime directorate. The maritime and rail directorates worked together in responding to the legal action and reaching a settlement with Eurotunnel.

### **Issues the Department considered in responding to the legal action by Eurotunnel**

**2.6** In responding to the legal action, the Department considered:

- the likelihood of the Department successfully defending the action taken by Eurotunnel;
- the risk that the court would impose a decision that would stop the Department from using the additional freight capacity it had secured; and
- the timing of the court action and when any measures could take effect if the Department was not successful in defending the court case.

The Department believed it could manage the risks it faced when legal action began

**2.7** The Department assessed that it was unlikely to successfully defend a challenge to its procurement of freight capacity. While the Department had judged that it could argue its reason for proceeding was "extreme urgency" it thought a court was unlikely to accept that this complied with regulation rules. The Department had taken the view that it only became clear in October 2018 that its intervention in the market would be needed for the following reasons:

- Government policy was for a deal with the European Union (EU) to be reached and the expectation was that a deal would be reached and ratified. It was only at this point that no deal became a realistic possibility.
- The likely approach of European countries to border control was better known.
- The Department concluded that there were "unexpected and unforeseeable limitations on the extent to which the market had by that date been able to respond to these circumstances by putting in place contingency plans to deal with this scenario".<sup>10</sup>

**2.8** The Department considered the legal remedies that could stop it from making use of the contracts with the ferry operators. The most significant of these might include a ruling that the contracts were ineffective (which would cancel the future obligations under the contracts).

<sup>10</sup> See further, National Audit Office, *The award of contracts for additional freight capacity on ferry services*, Memorandum to the House of Commons Committee of Public Accounts, February 2019.



**2.9** A key factor in the Department's thinking prior to the initial court hearing on 11 February 2019 was its understanding that a trial would not take place until after 29 March 2019. The Department assumed that any trial would then take place in a situation where:

- an exit deal had been agreed and ratified. There would be no need for the additional capacity that the Department had secured to move essential goods, and as a result the Department may have already cancelled some or all of the additional capacity ahead of the trial; or
- the UK had left the EU with no deal. There would be an urgent need for the additional capacity that had been secured to transport critical goods. In this situation the Department did not consider it likely a court would cancel contracts that were being used to transport essential medicines.

**2.10** Based on this assessment the Department decided to prepare for litigation if the dispute could not be otherwise settled. The Department at this time was principally guarding against potential financial loss, as it did not believe a ruling that the contracts were ineffective would take place before 29 March 2019. There was the potential for an injunction ahead of this – which would suspend the contracts – but the Department believed it would be able to argue against this successfully in court.

The court setting a trial date for before 29 March 2019 significantly altered the Department's assessment of the risks it faced

**2.11** The initial court hearing took place on 11 February 2019. At the hearing Eurotunnel asked the court for an expedited trial. This was granted, with a four-day trial set to begin on 1 March 2019. The Department informed us that, consistent with the views of its legal advisors, it considers that this level of expedition was exceptional.

**2.12** The timing of the trial introduced a significant time pressure for decision-making. The Department had 17 calendar days, from 11 February 2019 until the start of the procurement trial, in which to consider its options, the risks, decide how to proceed and conclude any necessary action. This put the Department on a highly accelerated timetable.

**2.13** The Department had been expecting to deal primarily with a financial risk in any litigation. The timing of the trial meant the government also now faced a risk to the delivery of capacity that would allow it to move critical goods. The early trial date made it possible that the court could impose a cancellation of the ferry contracts in early March 2019. The Department would then need to run a new procurement exercise for the freight capacity.

**2.14** The legal action also impacted on the Department's ability to secure additional freight capacity. The Department judged that it was not viable to secure additional capacity while legal action was in progress as this also carried a risk of being challenged. On 18 February 2019, the Department provided an undertaking to Eurotunnel that it would not enter into any contracts to secure additional freight capacity without providing three days' written notice of its intention to do so to Eurotunnel. This included activity to secure additional capacity either from a new provider or any agreement to extend freight capacity volumes or routes with the ferry operators the Department had already contracted with.

**2.15** In developing a settlement proposition the Department's priorities were to:

- ensure the government did not lose its ability to both use the freight contracts and pursue options to extend this capacity;
- minimise the cost of the settlement as far as possible;
- secure, as far as possible, a settlement that provided broader public benefits; and
- not expose government to undue criticism.

**2.16** In February 2019, the Department, to assist in its decision-making about whether to proceed with litigation, assessed the additional costs of securing freight capacity if the court cancelled the original contracts. The Department considered three options that involved different combinations of ferry and air freight capacity procured from the market alongside the use of two military vessels. The total additional costs to the Department ranged from £40 million to £97 million. These costs included, for example, payments to the two ferry operators on the cancellation of the original contracts, the additional costs of procurement, and an expectation that new contracts would be at a higher price than the original contracts.

**2.17** The Department considered that these options would not provide an adequate replacement for the capacity it had already secured. The Department judged that the earliest freight capacity would be available following a new procurement would be June (about 3 months). The time required to run a new procurement process and for operators to put in place the services meant that military vessels would provide a stop-gap service until newly procured freight could begin. However, the Department identified that the military vessels would not be able to provide the same capacity as they could not accommodate large volumes of freight accompanied by drivers.

## **How the Department arrived at a settlement figure of £33 million**

**2.18** The accounting officer assessment in December 2018 set out the Department's estimate that, if challenged, any legal remedies would not exceed £20 million. This damages figure was based on a challenger losing the opportunity to make profit on an awarded contract, and there being multiple challenges. The Department expected that the level of damages awarded by a court to any individual challenger might be reduced to reflect that the Department may not have awarded them a contract. The Department also identified other potential legal remedies, but these were not quantified.

**2.19** Eurotunnel's claim for damages (in respect to all its claims combined) amounted to approximately £80 million, considerably higher than the Department's estimate of potential damages.<sup>11</sup> The Department's estimate had only considered damages relating to the profit a ferry operator could have made had they won a contract. Eurotunnel's estimate focused on damages relating to the distortive impact the additional services might have on the market for cross-Channel freight services. The Department had not considered in depth this type of damages in its assessment of the initial procurement.

**2.20** Eurotunnel calculated the impact to its business of the Department's contracts, based on the number of trucks using the Channel Tunnel and the reduction in prices it could charge. Eurotunnel argued that the impact would last for up to four years, as the contracts could lead to customers changing their behaviour and the ferry operators securing longer-term business. Eurotunnel also argued that the contracts with Seaborne Freight (UK) Limited had the effect of the Department subsidising a new entrant to the market.

**2.21** After considering various approaches to determining a settlement value, the Department decided that the settlement should not exceed the costs of re-procuring the freight capacity should it have to, with this figure discounted to reflect that this was not a certain consequence should the case go to court. The Department used its estimates of the cost of potential re-procurement, including use of other options in the interim – air freight and military vessels. It estimated that it could face additional costs of between £40 million and £97 million depending on the combination of private ferry, military and air freight capacity used. These calculations, including an assessment of the likelihood of re-procurement having to take place, informed the Department's decision to negotiate up to a maximum of £35 million.

<sup>11</sup> On 12 February 2019 Eurotunnel submitted to the Department its estimate of approximately £75 million in losses. On 20 February 2019 Eurotunnel submitted a revised estimate of €92 million (approximately £80 million).

**2.22** The Department negotiated a settlement figure that was acceptable to Eurotunnel and below the maximum amount the Department was prepared to pay in a settlement. The negotiations on the settlement value intensified after 20 February 2019, when Eurotunnel submitted a claim for damages, and concluded on 28 February 2019. The final settlement figure reflects the outcome of these negotiations. The Department informed us that if it had not been able to negotiate a figure below its £35 million upper limit the litigation would have proceeded to trial.

**2.23** We set out in **Figure 3** the different costs outlined in this section.

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### Figure 3

Costs relevant to understanding the £33 million settlement with Eurotunnel

Description	Value
<b>Department's initial estimate of the most it would need to pay in damages in the event of a challenge:</b> In December 2018, the Department assessed that if its procurement was challenged any legal remedies would not exceed £20 million. This was based on an assessment of damages if there were several procurement challenges. The Department also identified other potential legal remedies, but these were not quantified.	Up to £20 million
<b>Eurotunnel's claim for losses:</b> Eurotunnel submitted a schedule of losses to the Department on 20 February 2019. The largest element of this was Eurotunnel's assessment of the impact the ferry contracts would have on the volume of traffic using its services and prices it could charge. Eurotunnel argued that it would impact its businesses over several years as other businesses would capture market share which it would need to win back.	Circa £80 million
<b>Department's estimate of additional costs to secure freight capacity if the court cancelled the contracts:</b> This ranged from an additional £40 million to £97 million, for example to reflect the costs of having to use military ships, on top of the original contract price of £87 million. These costs would be in addition to any damages paid to Eurotunnel.	£40 million to £97 million
<b>Department's assessment of the maximum amount it could pay to settle with Eurotunnel:</b> including the estimate of additional costs to secure freight capacity if the court cancelled the contracts and the likelihood of these costs materialising, as well as avoided litigation costs.	£35 million
<b>Settlement amount reached with Eurotunnel:</b> The Department agreed an out-of-court settlement with Eurotunnel which ended the legal action.	£33 million

Source: National Audit Office analysis of Department for Transport documents

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Government's decision to settle out-of-court was driven by the desire to avoid any risk that the ferry contracts were cancelled ahead of 29 March 2019

**2.24** The Department, sought cross-government agreement on whether to settle with Eurotunnel or proceed with the litigation. The decision had implications for the no deal preparations of other departments as the freight capacity had been procured so government could move critical goods in the event of no deal.

**2.25** The issue was put to ministers through an ad hoc ministerial meeting on borders and prioritisation which met to consider the Eurotunnel legal action on 26 February 2019. This group agreed that "Government should continue to do all it can to ensure sufficient freight capacity is in place to transport critical goods such as medicines". The committee instructed the Department to settle the case being "careful that any settlement did not fall foul of state aid rules".

**2.26** HM Treasury approved the Department's request to make a special payment to settle the case. The settlement is deemed a 'special payment' in *Managing Public Money*, the rule book for accounting officers on how to handle public funds.<sup>12</sup> A special payment is outside of the normal range of departmental activities and as such Parliament does not provide for these when voting department estimates or passing specific legislation.

**2.27** The accounting officer completed a formal assessment of the settlement against the standards of regularity, propriety, value for money and feasibility expected by Parliament for the use of public resources. An accounting officer assessment is undertaken on significant or novel policy and spending proposals. If it is assessed that a proposal is not compatible with the standards set out in *Managing Public Money* the accounting officer should advise their minister and seek a ministerial direction if the relevant minister wishes to proceed. This is a written instruction from the minister to carry out the action.

**2.28** The accounting officer judged that the risk of a court issuing a declaration of ineffectiveness was too great given the potential consequences for the ability of government to move critical goods in the event of a no deal exit, given the approach agreed by ministers including ensuring the unhindered supply of 'category one' goods including medical supplies into the UK. In reaching her judgment the accounting officer consulted the permanent secretary at the Department of Health and Social Care. The accounting officer also noted that developing a settlement value based on the potential costs to the department (see paragraph 2.21) had respectable arguments to support it but, as this approach has not been formally tested in litigation before, there was a risk that some part of the settlement figure might be deemed unlawful state aid if challenged. The settlement agreement includes a clause requiring Eurotunnel to repay the Department should any amounts be found to be unlawful state aid in the event the agreement is challenged by third parties. Overall the accounting officer concluded that the requirements of *Managing Public Money* were met and noted that under other circumstances the most appropriate outcome would have been to continue to trial.

<sup>12</sup> HM Treasury, *Managing Public Money*, July 2013 with annexes revised as at March 2018.

**2.29** On 28 February 2019, the Department agreed a £33 million out-of-court settlement with Eurotunnel to end the legal dispute. The Department will pay Eurotunnel in three £11 million instalments over the next three financial years. The first payment was made on 5 April 2019. Under the settlement agreement both sides paid their own legal costs incurred in the dispute. The legal costs for the Department, both in relation to the settlement and the Eurotunnel litigation, totalled approximately £1 million. The Department was advised by the Government Legal Department and its external legal advisers, Slaughter & May, who had advised on the initial procurement.

# Part Three

## Eurotunnel's commitment under the settlement agreement

**3.1** The Department for Transport's (the Department's) settlement agreement with Eurotunnel also documented a commitment given by Eurotunnel to spend at least £33 million on agreed activities. This part sets out:

- the type of projects permitted under the settlement agreement; and
- the Department's oversight of Eurotunnel's projects.

### **The type of projects permitted under the settlement agreement**

Eurotunnel has agreed to commit at least £33 million on permitted projects

**3.2** The settlement agreement includes a commitment by Eurotunnel to spend at least £33 million on projects relating to the Channel Tunnel site's infrastructure, including security and border preparedness measures. The list of permitted projects can include, for example, the development of infrastructure to reflect the changes that will be required at the border after the UK leaves the EU, and projects to support longer-term resilience at the Channel Tunnel.

**3.3** The projects are to be undertaken on the UK side of the Channel Tunnel unless otherwise agreed by the Department. An exception to this is projects that relate to counterterrorism measures, which may be undertaken at the French terminal. Examples of permitted projects set out in the agreement are shown in **Figure 4** overleaf.

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## Figure 4

The settlement agreement between the Department for Transport and Eurotunnel sets out permitted projects, and activities that will not be considered permitted projects

### The scope of permitted projects is wide

The settlement agreement sets out that:

- These projects are to adapt to the greater complexities at the border following the UK's departure from the EU and/or to support longer-term resilience in the light of the significant continuing importance of the Channel Tunnel in the transport of critical goods.

Projects that support longer-term resilience will include security measures (including counterterrorism measures), border preparedness measures and site infrastructure enhancements to improve the resilience of the UK terminal and immediate surrounding environment, such as:

- a projects to assist in access to the UK terminal;
- b projects to assist in improving traffic flow on the UK terminal;
- c projects to assist in enhancing and improving counterterrorism measures on, in and around the UK terminal;
- d projects to assist with making changes in border preparations;
- e projects to assist in the development of rail freight traffic (not shuttles) including the development of Dollands Moor freight yard to reduce operational dependency on the UK Channel Tunnel terminal and increase resilience for Channel Tunnel traffic;<sup>1</sup> and
- f such other projects of similar nature and object as those listed in sub-paragraphs a-e above as the parties shall agree (each a 'permitted project').

Activities that will not be considered permitted projects are:

- a purchase of new rolling stock;
- b infrastructure development on the French terminal (except as it relates to counterterrorism measures and other distinct projects by exception);
- c any expenditure which would likely be prohibited by law of any jurisdiction to which either party is subject; and
- d the ElecLink project initially presented to the Channel Tunnel Intergovernmental Commission in February 2012 or any current or future project of a similar nature.

### Note

- 1 Dollands Moor is a railway freight yard in Folkestone. The site is currently operated by DB Cargo under a lease from the British Railways Board.

Source: National Audit Office analysis of Department for Transport documents

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**3.4** Irrespective of the settlement, Eurotunnel informed us that it would have committed in excess of £33 million to work that falls within the definition of permitted projects. Eurotunnel agreed the scope of permitted projects with reference to projects that it had wanted to progress in any case. During negotiations, Eurotunnel raised with the Department specific projects it wished to undertake, such as work to develop additional security controls. These would potentially be among the projects permitted under the settlement. Since mid-2018, Eurotunnel had been implementing an action and investment plan in response to the UK's exit from the EU. Eurotunnel has stated that the settlement enables it to "carry out its major projects aimed at developing and enhancing the Channel Tunnel site's UK infrastructure to support the long-term resilience of the system including security and border measures that will facilitate the flow of vehicles". Eurotunnel's major investments across its business in 2018 totalled €284 million.<sup>13</sup>

**3.5** The accounting officer's assessment did not explicitly consider the risk that attaching obligations to the settlement could create the perception that it was procuring work from Eurotunnel and we have not seen written advice on this issue. However, the Department informed us that this issue was discussed and considered, including by the accounting officer, as the settlement was being developed. The potential for a challenge on these grounds was raised in press and parliamentary reaction to the announcement of the settlement. The Department informed us that the £33 million settlement represents a payment to end the legal dispute and is not a procurement as, for example, Eurotunnel is not obliged to spend it on specific projects. Alongside the settlement, Eurotunnel has committed to spend at least £33 million on certain categories of projects, over which Eurotunnel has wide discretion as to how to commit the money. The Department informed us that Eurotunnel's commitments under the settlement agreement are intended to ensure that Eurotunnel prioritises projects with broader public benefits.

<sup>13</sup> GetLink SE, '2018 Registration Document', 2018. Available online: [www.getlinkgroup.com/uploadedFiles/assets-uk/Shareholders-Investors/Publication/Registration-Doc/2018-Registration-Document-Getlink-SE.pdf](http://www.getlinkgroup.com/uploadedFiles/assets-uk/Shareholders-Investors/Publication/Registration-Doc/2018-Registration-Document-Getlink-SE.pdf), accessed 3 May 2019.

## **The Department's oversight of Eurotunnel's projects**

The Department will assess if Eurotunnel has committed £33 million on permitted projects

**3.6** The Department included in the settlement agreement a process to provide it with oversight of how Eurotunnel is committing money to permitted projects. The Department will receive at least four reports from Eurotunnel setting out what projects Eurotunnel has committed money to.<sup>14</sup> The reports will be audited by Eurotunnel's statutory auditors, unless agreed otherwise with the Department, and will set out the detail of:

- all amounts committed to, or spent on, permitted projects;
- each permitted project commissioned, commenced or ongoing; and
- how the amounts have been committed to or spent on these projects.

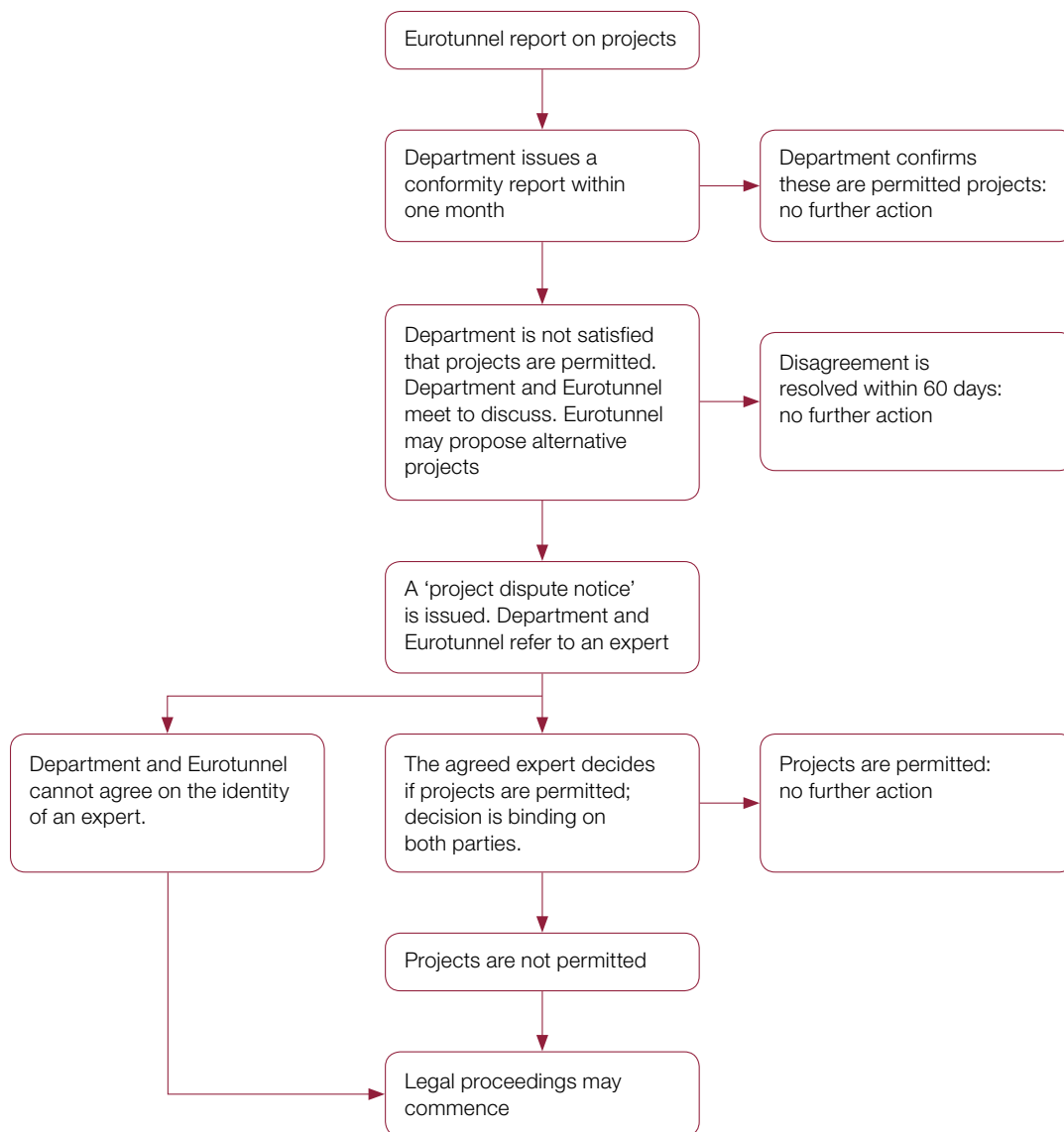
**3.7** The agreement contains a dispute mechanism if the Department does not believe that Eurotunnel has committed money to permitted projects. **Figure 5** outlines this process. If a dispute arises while there is a further settlement payment due, the Department remains obliged to pay this to Eurotunnel.

<sup>14</sup> During the course of our work we identified that there was a gap in the reporting period specified in the settlement agreement. As a consequence, the Department and Eurotunnel agreed a deed of variation to the agreement that removed that reporting gap.

**Figure 5**

The settlement agreement between the Department for Transport and Eurotunnel includes a dispute mechanism

The Department will receive reports on how money has been committed to projects and can dispute this if not satisfied

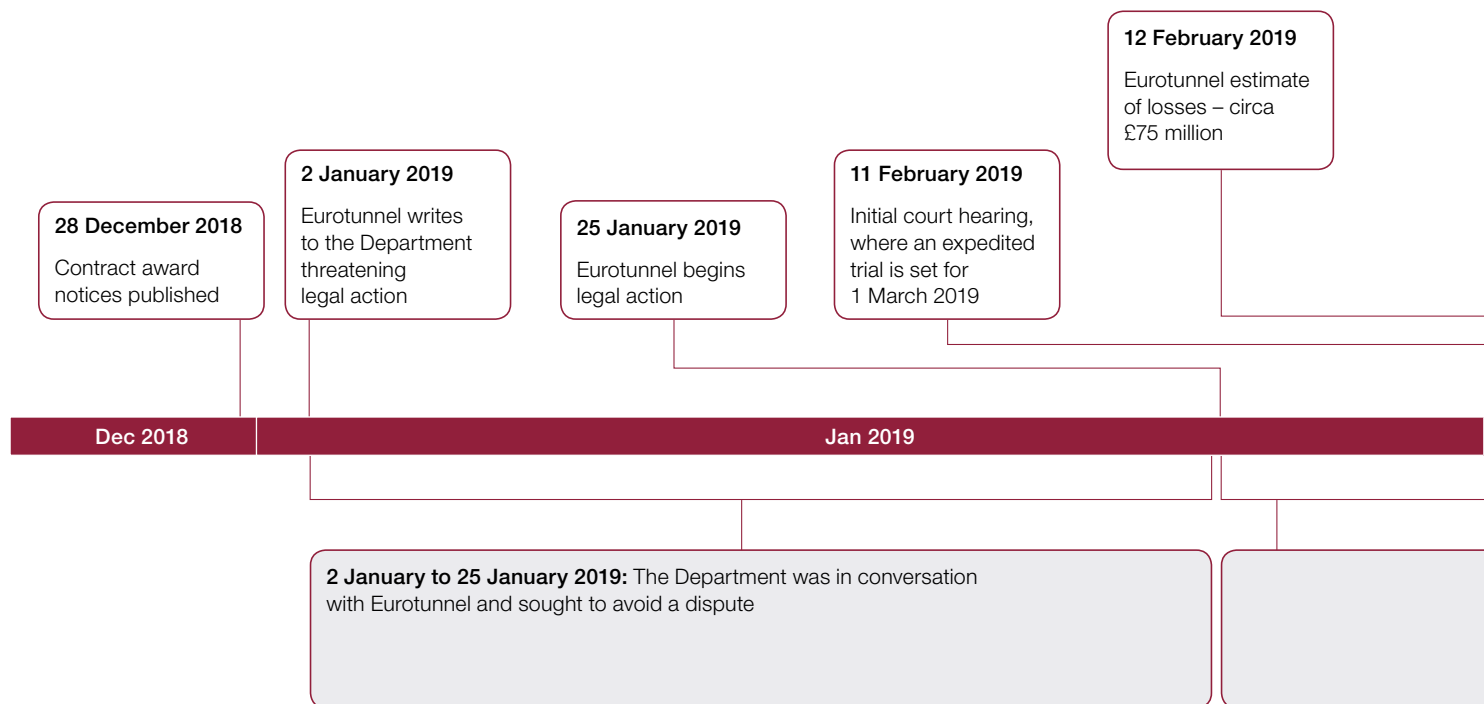


Source: National Audit Office analysis of Department for Transport documents

# Appendix One

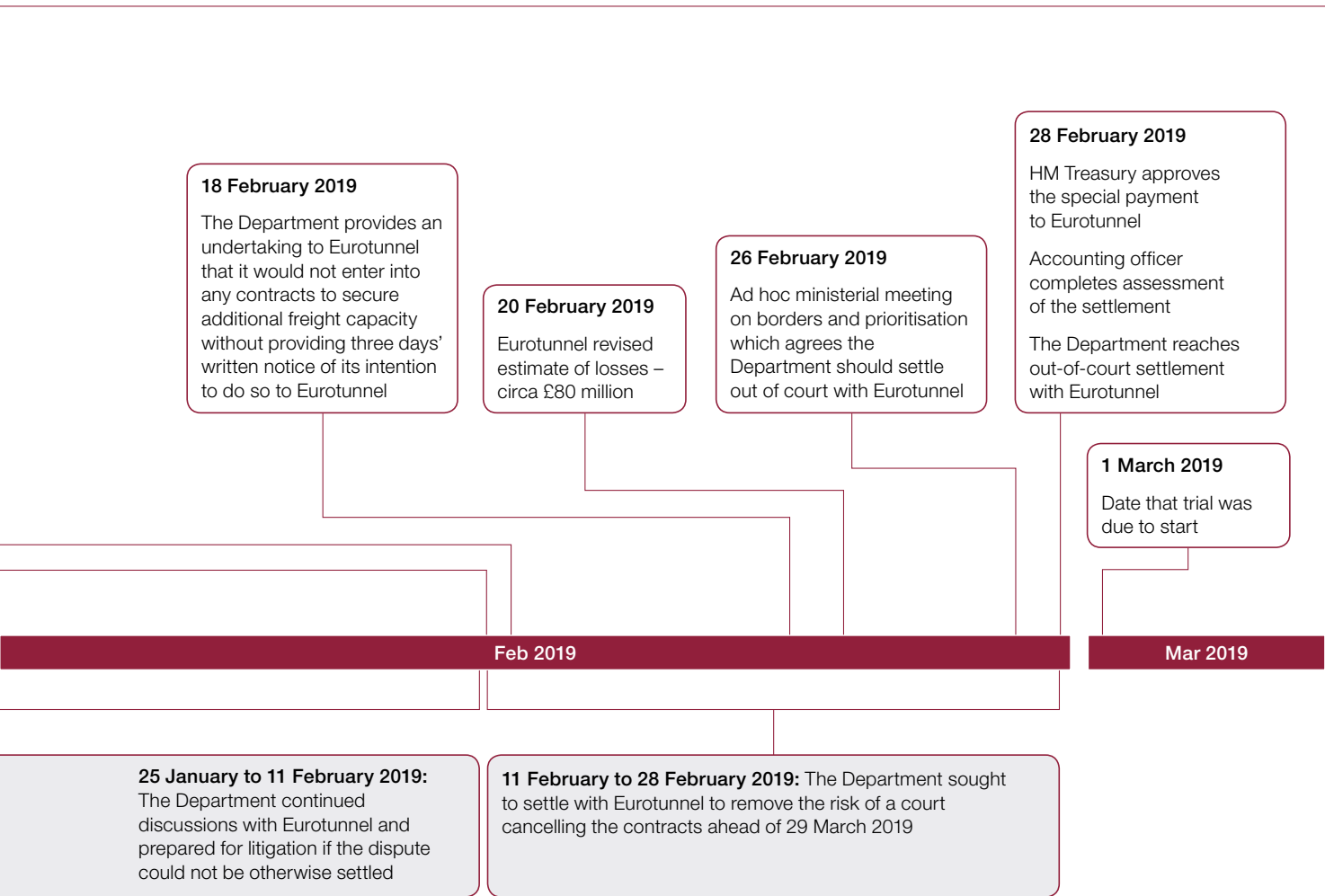
## Timeline of key events

**Figure 6**  
 Timetable of key events in the Department for Transport’s settlement with Eurotunnel



**Notes**

1 A timeline for the procurement was included in Appendix One of National Audit Office, *The award of contracts for additional freight capacity on ferry services*, Memorandum to the House of Commons Committee of Public Accounts, February 2019



# Appendix Two

## The scope and evidence base for this memorandum

### Scope

1 This memorandum has been prepared to support the Committee of Public Accounts (the Committee) to consider the approach the Department for Transport (the Department) took in reaching an out-of-court settlement with Eurotunnel.

2 This memorandum is intended to provide the Committee with a factual account of the steps taken by the Department. We have examined:

- the Department's consideration of the risk of legal challenge ahead of procurement;
- the Department's decision to settle with Eurotunnel; and
- Eurotunnel's obligations under the settlement agreement.

### Evidence base

3 We have produced this memorandum after reviewing evidence collected between 22 March and 9 April 2019. We:

- interviewed officials involved in reaching a settlement with Eurotunnel to understand the decision-making process; and
- reviewed key documentation held by the Department. This included the settlement agreement with Eurotunnel and documentary evidence of the approach to settling with Eurotunnel.

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