

Concept Symposium 2006 Principles of Governance for Major Investment Projects

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The Governance of Major Projects: Lessons from the Channel Fixed Link

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**The Governance of Major Projects:
 Lessons from the Channel Fixed Link**
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Lessons from the Channel Fixed Link

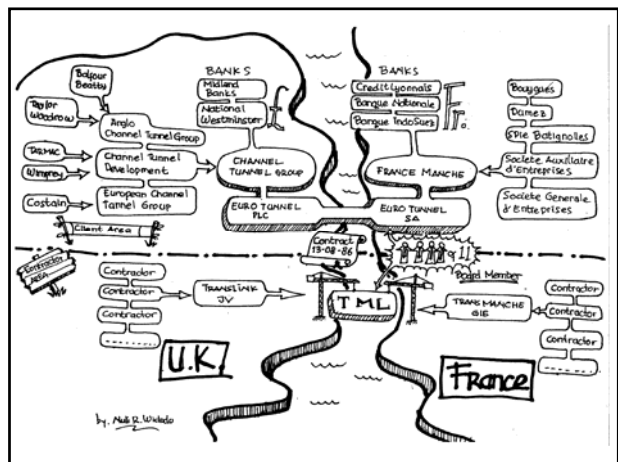
- Why revisit the Channel Fixed Link?
 - Most agreements were for a 20 year period from 1986
 - Confidential information on financial arrangements only emerging recently
 - The benefits of hindsight
- A brief history
- Analysis : the generic project processes
- Lessons for the governance of major projects

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A BRIEF HISTORY

- Treaty of Canterbury signed 12th February 1986
 - Established Intergovernmental Commission (IGC)
 - Article 1 forbids government funds or guarantees
- IGC signs concession agreement with Eurotunnel 12th March 1986
 - Eurotunnel listed on stock exchanges November 1987
- Eurotunnel signs construction contract with TransManche Link (TML)
 - FIDEC based
 - 13th August 2006
 - Eurotunnel recapitalised September 1986
 - TML members no longer majority shareholders in Eurotunnel
- Eurotunnel and railways operators sign Channel Tunnel Usage Agreement July 1987
 - 50% of tunnel capacity for 20 years

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Budget Performance

| £m 1985 prices | 1986 Budget | 1990 Forecast | 1994 Outturn | % increase |
|-----------------|-------------|---------------|--------------|------------|
| Tunnels | 1329 | 2009 | 2110 | 59 |
| Terminals | 448 | 491 | 553 | 23 |
| Fixed equipment | 688 | 814 | 1200 | 74 |
| Rolling stock | 245 | 583 | 705 | 188 |
| TOTAL | 2710 | 3897 | 4568 | 69 |

Source : Eurotunnel Rights Issue Documentation 1990 & 1994

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Major Projects Performance Benchmarks

| Performance Criterion | Megaprojects ¹ Average | Channel Fixed Link |
|---------------------------|-----------------------------------|--------------------------|
| Budget increase | 88% | 69% |
| Programme Overrun | 17% | 14.2% |
| Conformance Quality | 53% not up to expectations | Performed as expected |
| Operational Profitability | 72% not profitable | Operationally profitable |

1) source : Merrow (1988)

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The Current Situation 1

- Frequent capital restructurings
 - 70% of debt now held by US hedge funds and monoline insurers
 - Senior debt holders retain rights of substitution
 - 90% of privately held shares in French hands
- Scale of debt burden admitted February 2004
 - Debt £6b
 - Annual interest £318b
 - Operating profit £170m
- Channel Tunnel Usage Agreement ends 2007
 - Provides 50% of income (£232m)
 - Based on 10m Eurostar passengers/year + 5m tonnes freight
 - 2003 figures 6.3m + 1.75 m respectively and Eurostar losing money
 - Eurostar has over two thirds of cross Channel passenger market

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The Current Situation 2

- Compulsory debt repayments start in 2006
- *Procédure de sauvegarde*
 - French equivalent of Chapter 11
 - 11th July 2006 Eurotunnel makes application
 - Granted 2nd August by French courts
 - Ceases to pay interest on the £6.18m debt for 6 months
- Substitution looms in 2007
 - Senior debt-holders would run the facility for cash

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UNDERSTANDING THE MANAGEMENT OF MAJOR PROJECTS

- The generic project processes
 - Defining the project mission
 - Mobilising the resource base
 - Riding the project life-cycle
 - Leading the project coalition

Source : Winch 2000/2002

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Defining the Project Mission 1

- The importance of front-end definition
 - Merrow/Morris/ Miller and Lessard
- Eurotunnel “assembled round a hole like a Polo mint..”
 - Sir Alistair Morton
- “Largest civil engineering project.....”
 - UK White Paper 1985
- “an integrated transport system”
 - Interview 12/2/93
- Consequences of Poor Definition
 - Failure to include transport equipment interests in TML joint venture
 - Failure to plan and resource commissioning
 - Adversarial relations with transport equipment interests
 - Continual design changes

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Defining Project Mission 2

- Stakeholder management
 - Cleland; Winch & Bonke
 - Few environmental issues (the advantage of tunnels?)
- A stakeholder perspective on success and failure

| <i>Internal</i> | <i>External</i> |
|-----------------------------|-------------------------------|
| • Eurotunnel +++ | • Travelling public +++ |
| • TML ++ | • British and French states + |
| • Workers + | • Local communities +/- |
| • Contractors & suppliers + | • financiers - - - |
| • Shareholders +/- | • Future generations +++ |

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Defining the Project Mission 3

- Regulatory intervention
 - Merrow et al
 - IGC agreed in principle that Le Shuttle passengers could stay with cars in December 1989
 - IGC instructed Eurotunnel to increase width of Le Shuttle fire doors in April 1991
 - Generated serious dispute with Bombardier
 - 10 year extension of concession in compensation

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Defining the Project Mission 4

- **Governability**
 - Miller and Lessard
 - TML effectively signed a contract with itself
 - Lack of trust in contract by funding banks
 - Morton's theatrical tough act

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Defining Project Mission 5

- Optimism bias
 - Flyvbjerg et al
- “in banking you bid high and then trim your margin; in contracting you bid low and then get your profits on the variations” (Colin Stannard, Eurotunnel)
- “the project price.. was put together to convince the governments, it was a viable price, a promoter's price. What is was not was a contract price” (Taylor Woodrow)
- The Eurostar passenger forecast of 17m year was put forward to make business case for private funding viable and never believed internally (Guillaume Pepy, formerly SNCF, now Eurostar Group)
- “as marketer of the [IPO], I had successfully sold the market a pup” (David Freud, Warburg).

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Governing the Project Coalition

- **The construction contract**
 - Tunnelling works : incentive contract
 - Terminals and fixed equipment : fixed price contract
 - Transport equipment : fee based contract
- **Contract performance**
 - Incentive contract : on time with 59% overrun
 - Fixed price contract : 12 months late with 54% overrun and generated most of the disputes
 - Fee-based contract : 24 months late with 188% overrun

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Riding the Project Life-cycle

- Logistically, but not technologically challenging
- Few external surprises
- **Internal dynamics critical**
 - “we had to have the concrete on the table in a hurry” (PM of Storebælt project)
 - Fear of political change in 1987 election
 - “we had to blast on with the tunnel design”
 - Failure to devote engineering resource to terminals and fixed equipment generate design changes and rework
- **Continual renegotiation of schedule and budget rendered normal project planning techniques unviable**

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Leading the Project Coalition

- Punishing on reputations and marriages
- Morton's aggressive style
 - Theatricality became counterproductive
- **Cultural differences *not* an issue**
 - Euro-technical English (Chevrier)
 - Fomentation of national rivalry as motivation technique
 - “l'achèvement du Projet tient du miracle compte tenu des différences culturelles linguistiques, morales et sociales. La réussite résulte probablement dans l'adhésion d'une majorité à un objectif commun”

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LESSONS LEARNED 1

- Clearly separate promoters and contractors
- Break the problem down into packages
 - Channel Tunnel Rail Link
- Strong clients mean successful projects
- Define the project mission fully
- Incentive contracts work
 - Risk sharing, not risk transfer

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Lessons Learned 2

- **Don't believe the PPP myth**
 - The public sector can never transfer significant risks to the private sector
- **The private sector has no inherent advantage in investment appraisal**
 - The culture of investment banking is deal-making, not analysis
- **Understand optimism bias**
 - Organisational/political/psychological – a major research challenge
 - Can stage/gate processes overcome the optimism dynamic?

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What Would you Do?

Eurotunnel is, in effect, bust; it cannot repay its debts on its current operating basis. Now that the tunnel is built, the public interest is in maximising its use, yet the Anglo-French treaty that created it forbids public support to help it do so.

Leader, *Financial Times* February 24th 2004

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