

Report to Partnership Meeting – 8th October 2009

EUROPEAN FUNDING

START PROJECT

ELGIN TO INVERNESS AIRPORT JET BUS ROUTE EXTENSION

PURPOSE OF REPORT

To report to Members on the progress made by officers developing and delivering the extension to the JET bus service to Inverness Airport to include hourly links to Elgin. The extension of the JET service to Elgin was approved by Members for inclusion in the START Project Programme at the Partnership meeting in Kirkwall in April 2008.

BACKGROUND

HITRANS secured funding from the Scottish Government's Bus Route Development Grant Scheme in March 2007 for a £2.1Million upgrade of bus services operated by Rapson's Group in Inverness with a particular focus on upgrading links to Inverness Airport.

At the outset a key aspiration of this project was to establish access to Inverness Airport for residents of Moray who in the past were better served by bus links to Aberdeen Airport rather than the nearer Airport at Inverness. Rapson's Group were unwilling to operate a direct service to Inverness Airport from Elgin and opted instead to include a new service from Nairn to Inverness Airport that was timed to link with buses operated by Stagecoach to points in Moray and beyond. With the sale of Rapson's Group bus companies to Stagecoach in 2008 the opportunity arose for the Inverness to Inverness Airport service to extend to Elgin.

Stagecoach withdrew direct links from Moray to Aberdeen Airport in 2008 on the basis that the impact of the detour from the A96 to the Airport could not be justified by passenger carryings as the number of people using the service to the Airport was low when compared to those travelling from end to end of the route. Following this decision Moray Council called a productive meeting where it was agreed that the Council and HITRANS would look at options to improve access to Airports for people in Moray.

HITRANS and Moray Council officers met with Stagecoach to discuss options for improving bus links to Moray from both Inverness and Aberdeen Airports. Stagecoach agreed to strengthen connections with Service 10 coaches to re-establish a link, albeit through a service change, to Aberdeen Airport. Stagecoach also agreed to look at how they could deliver a direct service from Moray to Inverness Airport and at what cost. To maintain fairness and openness in the process discussions were also held with the other operator who provided a limited service between Moray and Inverness to establish if there could be potential for an alternative operator

to establish a link to Inverness Airport. These discussions established that this operator did not wish to bid for funding to establish a service to Inverness Airport.

HITRANS success in securing ERDF funding through the START project has provided funding to allow an Inverness Airport to Moray bus service to be established. This project was included in the list of START projects approved by the HITRANS Board in April 2008.

SERVICE UPGRADE

In partnership with HITRANS and Moray Council, Stagecoach developed an option that saw the existing JET 11 service extend from Inverness Airport to Elgin on an hourly basis. This package of improvement also included reducing a gap in the timetable between services in the afternoon and extending the timetable through additional early morning and evening services. This timetable was approved by HITRANS and Moray Council officers as satisfying our aspirations for this service. A particularly welcome element of this project has been the commitment of Stagecoach to procure two new low floor Enviro 300 buses from Alexander Dennis Limited to deliver the initial service. These buses will be branded in the JET livery and will also offer passengers a high quality environment for their journey with leather seats and safety belts installed in the new vehicles.

The improved service also benefits passengers travelling between towns on the route as it offers the option of low floor buses for the journey that did not previously exist. Now passengers travelling between Elgin, Forres, Nairn and Inverness can do so on super low floor buses offering easy access for wheelchairs and parents with pushchairs. These buses are also very popular for anyone whose mobility makes it difficult to negotiate the steps on a coach.

The kick start project that establishes the new link to Elgin on the existing JET 11 bus service requires a total estimated investment of £310,000. The majority of these costs are to be borne by Stagecoach Bluebird who will fund the purchase of two new high specification buses for a total cost of £250,000. The remaining £60,000 is the additional operating costs less new revenue generated for the first 12 months of operation and this cost will be met by HITRANS through the START project. The service is expected to become commercially viable at the end of this 12 month period.

The service commenced operation on 18th May 2009 and the new buses are scheduled to enter service in October 2009. The new link was launched by local MSP and Cabinet Secretary for Rural Affairs, Richard Lochhead.

The investment by HITRANS complies with EU State Aid rules and details of the process through which kick start funding is permitted is included as Appendix A of this report. This information is taken from the guidance to applicants produced by the Department for Transport in relation to their £25Million Kick Start Bus Funding Competition 2009 which is available to English local authorities and Integrated Transport Authorities. Full details of this are available at <http://www.dft.gov.uk/pgr/regional/buses/busgrants/kickstart/>.

SERVICE MANAGEMENT AND MONITORING

The enhanced JET 11 service with its expanded route will be subject to the same management and monitoring of the service that is already in place for the services funded through the original bus route development scheme. Stagecoach will add this information to their monthly reporting and invoicing processes and they are also required to submit passenger and revenue information to HITRANS.

RECOMMENDATIONS

1. Members are asked to note the report.

Report by: Ranald Robertson
Designation: Partnership Manager
Date: 15th September 2009
Background Papers: Appendix A – Extract from Annex B of the Department for Transport
Guidance on the Kickstart Bus Competition 2009

Appendix A - Extract from Annex B of the Department for Transport Guidance On the Kickstart Bus Competition 2009

Tendering and Kickstart, EU State Aid and Procurement Rules

Note: *The contents of this Annex broadly set out the relevant legal provisions which need to be considered by authorities and operators when preparing Kickstart bids. It is not, and should not be taken to be, a definitive statement of the law. It is not legal advice and does not represent the views of the Department for Transport (save where this is made explicit). You are strongly advised to take independent legal advice when preparing your bids and before submitting proposals.*

1. A local authority's financial commitment to a Kickstart project is likely to involve one or more of the following:

revenue support for the initial years of the route's operation;

a contribution to the costs of provision of new vehicles for use on the route;

other investment, most likely to be in terms of capital expenditure, related to the improvement of the route.

The first two of these raise issues in terms of the requirements of the tendering provisions of the Transport Acts and EU rules on state aid and procurement.

Revenue Support

2. Where an authority enters into an agreement with an operator that requires the local authority to make payments to the operator, in return for which the operator provides a bus service that constitutes an "agreement providing for service subsidies" for the purposes of the Transport Act 1985. Consequently, entering into an agreement for revenue support for a Kickstart route is covered by the tendering provisions of the Transport Acts 1985 and 2000 (i.e. specifically, sections 89-92 of the 1985 Act, as amended by section 152 of the 2000 Act). The Local Transport Act 2008 (sections 67-70) has also extended the circumstances under which subsidy can be used to secure passenger transport services (e.g. to obtain improved standards of service), and has changed the maximum length of subsidised services agreements (from 5 to 8 years).

3. The tendering provisions require that any revenue support arrangement should be the subject of a contract with the operator concerned and that contract should be competitively tendered except where it has been awarded under the provisions of the *de minimis* regulations. The *de minimis* provisions were significantly broadened in April 2004 (by the Service Subsidy

Agreements (Tendering) (England) (Amendment) Regulations 2004 .SI 2004 No 609.

4. However all cases where authorities grant revenue support to operators are potentially subject to the prohibition on state aid. It is important to note the effect of European Regulation 1191/69 (see paras 16-24 below.) The Public Contracts Regulations 2006 (which implement EU Directive 2004/18/EC on the co-ordination of procedures for the award of public works contracts, public supply contracts and public services contracts) may also be relevant (see paras 5-10 below). The 2006 Regulations repealed and replaced a number of earlier Regulations, in particular the Public Services Contracts Regulations 1993 (SI 1993/3228) and the Public Supply Contracts Regulations 1995 (SI 1995/201).

The Public Contracts Regulations 2006

5. The Public Contracts Regulations 2006 (S.I. 2006/5) ("PC Regulations") implement EU rules on the co-ordination of procedures for the award of various forms of public contract, and they must be complied with whenever an authority awards a public contract for the provision of certain services. However the PC Regulations do not apply to public contracts which are excluded by regulation 6 (certain specified types of contract) or regulation 8 (thresholds, on which see paragraph 8 below).

6. Some common forms of revenue support arrangements between an operator and an authority will not be "public contracts" for the purposes of the PC Regulations. Specifically, the PC Regulations do not apply to offers in relation to a services concession contract awarded by the contracting authority.¹ The European Commission issued an Interpretative Communication on Concessions under Community Law in 2000 (OJEC C121 29.4.2000).

7. The Communication identifies the distinguishing features of a public service concession contract:

- (a) The operator bears the risk involved in operating the service in question (establishing and exploiting the service). The way in which an operator is remunerated is a factor which helps to determine who bears the exploitation risk – the risk is probably transferred where the operator obtains significant part of revenue from operating the service, particularly by charging fares in any form.
 - (b) The nature and purpose of the activities that are the subject of the contract are likely to be the State's responsibility and may be subject to exclusive or special rights.
8. Contracts which are likely to be concession contracts are contracts where the operator bears the revenue risk of providing the service, that is, contracts where the operator receives a net subsidy from the authority and retains the revenue from the service (often termed "net cost", or "minimum subsidy", or

¹ Public Contracts Regulations 2006, regulation 6(2)(m)

ensures that revenue risk lies with the operator - and where the authority has not entered into any other arrangement to protect the operator from revenue risk (such as an indemnity clause) - are therefore not likely to be subject to the requirements of the PC Regulations. Specifically, they are outside the need for contracts of above the threshold set by the EU rules (these thresholds are set out in detail in regulation 8 of the PC Regulations) be advertised in the Official Journal of the European Community (OJEC).

² See, for example, Article 16 EC.

9. Authorities will wish to consider the implications of the above for contract procedure under a Kickstart project. For example, a net cost contract awarded to a Kickstart operator under *de minimis* rules that falls within the definition of a public service concession contract would not be subject to the requirement to advertise in the OJEC or to conduct a competitive tender. Net cost contracts may be particularly relevant to Kickstart where the assumption is that the service is on its way to commercial viability.

10. Although the PC Regulations do not apply to the award of public service concession contracts, authorities should bear in mind that concessions are subject to the provisions of the EC Treaty and the principles of non-discrimination on grounds of nationality, equality of treatment, transparency, mutual recognition and proportionality. Further guidance on these principles, and compliance with them, is provided in the Commissions Interpretative Communication on Concessions referred to above in paragraphs 6 and 7.

11. In the context of developing Kickstart procedures, we recommend that authorities adopt an open process of consulting bus operators about the possibility of Kickstart initiatives in their area, and inviting proposals. In doing so, authorities should indicate whether for example they would be prepared to consider contributing to the cost of vehicle acquisition as part of a Kickstart proposal. This consultation process will contribute to transparency, as well as ensuring that no potential ideas are overlooked. Reference in public documents, such as Council committee papers, and policy statements, to the intention to consider proposals and to the subsequent decision-making process, will also contribute to demonstrating transparency. However, authorities should note that the degree of transparency required is an uncertain area of EU procurement law. Commission guidance has emphasised the role of open competitive tendering.

State aid rules

12. State aid is, in principle, incompatible with the common market as it is said to distort competition between Member States if a benefit is conferred on a domestic undertaking/business. However, EU law also recognises that Member States must be able to provide public services and further legitimate aims such as enhancing social cohesion which may conflict with the prohibition on state aid.²

13. The state aid rules only apply to measures if all the criteria listed in Article 87(1) of the EC Treaty are satisfied. They are:

a transfer of state resources
economic advantage
selectivity
effect on competition and trade between Member States.

³ See “Vademecum – Community law on state aid” (30 September 2008) available at http://ec.europa.eu/comm/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf.

⁴ Case C-280/00 *Altmark Trans GmbH v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-7747.

⁵ There is a wealth of further information on state aid rules on the web sites of the Department for Business Enterprise & Regulatory Reform (<http://www.berr.gov.uk/whatwedo/businesslaw/state-aid/index.html>) and the European Commission (Competition section) (http://ec.europa.eu/comm/competition/index_en.html).

“Incompatible” state aid can still be permitted if it falls within either of the exemptions listed in Articles 87(2) and (3). The most common exemption clauses are those in Articles 87(3)(a) and 87(3)(c). These cover, respectively:

“aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment”;

“aid to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions contrary to the common interest”.

14. Various “sectoral” rules have been devised by the European Commission (the guardian of state aid requirements). In the transport sector most general state aid rules apply. However, the *de minimis* ceiling is decreased to EUR 100,000 for the road transport sector and transport equipment is in general not eligible for aid.³

15. The European Court of Justice case of *Altmark*⁴ has ruled that compensation for public service does not constitute an “advantage” within the meaning of Article 87 provided four cumulative conditions are satisfied:

the recipient has a clearly defined public service obligation to discharge

there is an objective and transparent system, established in advance for calculating compensation

compensation does not exceed the costs incurred in discharging the obligation, taking account of the relevant receipts and a reasonable profit margin and

where the provider is not chosen through public procurement procedures, the level of compensation is determined with reference to the costs which a typical undertaking would incur.⁵

Council Regulation (EEC) 1191/69

NB: Regulation (EEC) 1191/69 is to be repealed from 2 December 2009, and will be replaced by Regulation (EC) 1370/2007 (“Regulation 1370/2007”) on

⁶See Article 10(1) of 1370/2007.

*public passenger transport services by rail and road.*⁶ As Regulation 1370/2007 does not enter into force until 3 December 2009, it is unlikely that its terms will directly affect the 2009 Kickstart competition, but participants are advised to familiarise themselves with the Regulation well in advance.

Regulation 1370/2007 provides a framework on the awarding of contracts for “services of general interest” and sets out the rules which apply to awarding public service contracts in the field of passenger transport services. The requirements for the contents of public service contracts is covered by Article 4. Article 5 deals with the awarding of public service contracts. Local authorities are permitted to provide passenger transport services themselves or by “direct award” to a public service operator over which the local authority exercises a degree of control (Article 5(2) and Article 2(h) on the definition of a “direct award”). Where a third party (other than an internal operator) is used, a public service contract must be awarded following a competitive tendering process, subject to 3 exceptions. The exceptions are: low-level contracts (annual value of less than € 1m or which supply less than 300,000 km of public passenger services); emergency measures and regional or long distance rail transport: see Article 5(3-6). Member States are required to gradually come into line with the requirements of the Regulation, with the end of the transition period set for 3 December 2019.

16. Council Regulation (EEC) 1191/69 (“Regulation 1191/69”) establishes a particularly favourable state aid authorisation scheme for urban, suburban and regional passenger transport services. In summary, Regulation 1191/69 authorises an authority to pay compensation to operators in return for the operators assuming obligations to provide bus services. These arrangements are exempt from the prior notification procedure **provided** that the requirements of the Regulation are met. That is, arrangements that comply with the Regulation are effectively exempted from the scope of the state aid rules. The key requirements are described below.

17. Regulation 1191/69 distinguishes between two types of arrangements between an authority and an operator for the provision of bus services: “public service obligations” and “public service contracts”. It is necessary first to determine whether the funding arrangement involves a “public service contract” or a “public service obligation”, as the requirements of the Regulation are different for each arrangement.

18. It is the Department’s view that the term “public services contract” has the same meaning in Regulation 1191/69 as it does in the PC Regulations (see paragraphs 6 to 8 above which discuss this term). Therefore, a revenue support arrangement that is a public services concession contract is not a “public service contract” and it falls into the category of a “public service obligation”. All other arrangements for revenue support of bus services under the Kickstart scheme fall into the category of “public service contracts”.

Public services concession contracts: the “public service obligation” requirements

19. As noted above in paragraph 8, where a contract is a public service concession contract, the PC Regulations do not apply to the making of that contract and (assuming that the tendering provisions of the Transport Act 1985 also do not apply) there is no requirement to advertise or conduct a competitive tender. However, as noted in paragraph 10 above, the EC Treaty and principles must be complied with. Additionally Regulation 1191/69 requires that any compensation paid to the operator must comply with the common compensation procedures set out in articles 10 to 13 of the Regulation.

20. Different compensation procedures apply depending on the type of obligation that the operator assumes under the arrangement. There are 3 types of obligations set out in the Regulation: the obligation to operate, the obligation to carry and tariff obligations.

- (a) “the obligation to operate” is any obligation imposed on an operator, in respect of a route, to ensure the provision of a transport service satisfying fixed standards of continuity, regularity and capacity.
- (b) “the obligation to carry” means any obligation imposed on an operator to accept and carry passengers or goods at specified rates and subject to specified conditions.
- (c) “tariff obligations” means any obligation imposed upon transport undertakings to apply, in particular for certain categories of passenger, for certain categories of goods, or on certain routes, rates fixed or approved by any public authority which are contrary to the commercial interests of the undertaking and which result from the imposition of, or refusal to modify, special tariff provisions.

21. Article 10 of Regulation 1191/69 concerns the calculation of compensation for a non-tariff “obligation”, (i.e. compensation paid where an operator that has assumed an obligation to carry or an obligation to operate). The compensation should “be equal to the difference between the reduction in financial burden and the reduction in revenue of the undertaking if the whole or the relevant part of the obligation in question were terminated...” Article 11 sets out the amount of compensation that may be paid in respect of a tariff obligation. Article 12 applies to calculation of compensation for all 3 types of obligation and says “costs resulting from the maintenance of obligations shall be calculated on the basis of efficient management of the undertaking and the provision of transport services of an adequate quality”. There are further provisions concerning the calculation of compensation for these obligations and any authority determining the compensation to be paid under a contract should consult the Regulation.

22. The practical implication of these Articles is that the authority must satisfy itself that the price it negotiates for a contract is justified in terms of the costs to the operator of meeting the particular requirements of the contract and

does not involve a risk of over-compensating the operator for meeting those requirements. This of course is no more than good practice and best value principles anyway require. In this regard, authorities should consider including in an agreement with the operator provision that, if the financial success of the project turns out to have been significantly greater than forecast in the initial projections, the operator will contribute in cash or kind to the further development of the project. If this contribution is in the form of a commitment to continue to provide the service, Regulation 1191/69 may apply. If in another form, Regulation 1191/69 may not apply and state aid rules would need to be considered in that case. (see also paras 29-30 below)

23. In the context of revenue support for a Kickstart project, an authority should, on the basis of its negotiation with the operator and its knowledge of the bus tendering market, be satisfied that the support involved is no greater than is necessary to cover anticipated and justified losses in operating the route during the period of Kickstart funding.

Requirements for public service contracts

24. Where revenue support arrangement between an authority and an operator is a public contract (and is not exempted), the provisions of the PC Regulations apply. In addition, Regulation 1191/69 requires that a public service contract must cover the following points:

- (a) the nature of the service to be provided, notably the standards of continuity, regularity, capacity and quality;
- (b) the price of the services covered by the contract, which shall either be added to tariff revenue or shall include the revenue, and details of financial relations between the two parties;
- (c) the rules concerning amendment and modification of the contract, in particular to take account of unforeseeable changes;
- (d) the period of the contract; and
- (e) the penalties in the event of failure to comply with the contract.

Requirements that relate to public service contracts and public service obligations

25. Any decision to enter into a public service contract, or impose public service obligations by means of a public service concession contract must:

- (a) state the reasons on which the decision is based; and
- (b) be published in the appropriate manner.

26. It is the Department's view that the above requirements are met where;

- (a) an agreement is subject to the tendering provisions of sections 89-92 of the Transport Act 1985 (as amended), including the publication requirements of sections 90(3) and 91(7) of that Act; and
- (b) a contract has not been tendered. i.e. *de minimis* rules have been applied, but where the decision to award the contract has been recorded in a document which is open to public scrutiny.

Contributing to the costs of vehicles as part of a Kickstart project

27 A number of the earlier Kickstart projects involved authorities contributing to the costs of vehicle acquisition, though the Department does **not** see this as a necessary feature of all, or even most, proposals. Outside Kickstart, some authorities have considered purchasing vehicles which are then made over to operators for use on a route as part of a service subsidy contract, thus reducing the subsidy costs of enhancing the route by a requirement for higher vehicle standards.

28. In considering such proposals, authorities may wish to check their statutory powers governing these arrangements and ensure that all agreed terms are set out in a signed, written agreement.

29. There are a number of scenarios for an authority's involvement with vehicle acquisition. The implications of EU rules for different scenarios are quite complex and need to be carefully considered in each case. What follows summarises the main factors to take into account in a number of likely scenarios. In (a) to (c) case below it is assumed that the authority purchases all, or some, of the vehicles involved, and retains ownership.

(a)

The operator leases the vehicles from the authority. In this case state aid and procurement rules will generally be satisfied where the vehicles have been purchased at the market price following an appropriate procurement exercise **and** the operator pays a commercial rate to lease the vehicle.

(b)

The vehicles are made over to the operator in return for the operation of the service. This arrangement probably constitutes an agreement providing for service subsidies under the Transport Act 1985. In that case the requirements of that Act apply and the PC Regulations and the Regulation 1191/69, as described above, may also apply.

(c)

The arrangement for the operator's use of the vehicles involves a payment by the operator "in kind" (for example promotion and marketing of services) other than the operation of the service as such, i.e. there is not a service subsidy agreement under the terms of the 1985 Act. In this case the favourable state aid treatment available under Regulation 1191/69 (see para 16 above) probably does not apply and the authority will need to consider the applicability of the state aid rules.

(d)

A possible variant of the above scenarios is where the authority retains ownership of the vehicles for a period but subsequently transfers ownership to the operator. Any terms for such a transfer which involve terms which are more favourable than normal commercial terms (taking account for example of the age of the vehicles) will involve state aid issues. An alternative would be to make the transfer subject to a service subsidy agreement, in which case the considerations set out in (b) would apply.

30. There are also possible scenarios where the operator purchases and owns the vehicles and the authority contributes to the costs of the acquisition. Any such contribution will involve state aid issues. If the arrangement is covered by the terms of a service subsidy agreement the considerations set out in para 29(b) above apply.