Leicester ZEBRA Bid

Financial Case

August 2021

Leicester City Council

First Bus

arriva

Financial Case

Contents

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Overview

1. The purpose of this Financial Case is to demonstrate the affordability and long-term sustainability of the proposed investment programme, alongside securing the support of stakeholders and customers.

2. This case sets out the following detail for each of the three projects within the Leicester Bid:
    a. Whole life Capital Cost estimates
    b. Whole life Revenue cost estimates against a diesel equivalent
    c. Risk analysis associated with cost estimates
    d. Cost control procedures
    e. Long term financial sustainability
    f. Legal compliance

3. It also sets out a summary of the overall programme capital costs and funding revenue across the 3 financial years of the ZEBRA scheme.

Programme

4. The table below shows a summary of the proposed capital costs and their financing streams across the ZEBRA programme from 2021 – 2032. These take into account inflation through agreed price estimates and all exclude VAT.

5. These show the whole life capital costs of the programme, together with the proposed capital funding streams.

ZEBRA : Cost/Revenues						
		Total	**2021**	**2022**	**2023**	**2032**
Total Cost		£ 47,053,129	£1,819,308	£ 13,599,821	£ 27,554,000	£ 4,080,000
Operators/Council	**Local**	£ 28,056,282	£ 454,827	£ 7,202,455	£ 16,319,000	£ 4,080,000
DfT	**ZEBRA**	£ 18,996,847	£1,364,481	£ 6,397,366	£ 11,235,000	£ -
Contribution	**Local**	59.6%	25.0%	53.0%	59.2%	100.0%
Contribution	**ZEBRA**	40.4%	75.0%	47.0%	40.8%	0.0%

6. The cost of battery replacement in 2032 is indicative at this point in time, due to the rapid development in this market. However, it is the industry ‘best estimate’ cost currently being used for business planning purposes.

7. The table below shows this split by Bus and Infrastructure costs over time.

Leicester ZEBRA Programme						
		Total	2021	2022	2023	2032
Electric Buses in service		96	0	30	66	0
Bus/Battery Cost		£ 41,514,000	£ -	£ 11,100,000	£ 26,334,000	£ 4,080,000
Bus Grant		£ 14,842,500	£ -	£ 4,522,500	£ 10,320,000	£ -
Infrastructure Cost		£ 5,539,129	£1,819,308	£ 2,499,821	£ 1,220,000	£ -
Infrastructure Grant		£ 4,154,347	£1,364,481	£ 1,874,866	£ 915,000	£ -
Total Grant		£ 18,996,847	£ -	£ 6,397,366	£ 11,235,000	£ -
Total Operator		£ 28,056,282	£1,819,308	£ 7,202,455	£ 16,319,000	£ 4,080,000
Total Cost		£ 47,053,129	£1,819,308	£ 13,599,821	£ 27,554,000	£ 4,080,000

8. The programme consists of three projects, each with differing bus costs (and sizes) and infrastructure costs. These projects relate to separate expenditure by three local partners: First Bus, Arriva and the Council. Bus and Infrastructure costs are incurred in the period 2021-2023, with a proportion of these costs subject to grant assistance as shown above.

9. Battery replacement costs incurred in 2032 fall outside the ZEBRA funding window and will be totally incurred by the operator. They have been included in the above to show the level of financial commitment by the local partners. The table shows the whole life capital costs,also used within the Economic case to determine the overall benefit-cost ratios of the scheme.

10. The whole life costs of each project are shown as below:

Zebra Fast Track Bid - Financial Summary					
Aug-21					
First					
Buses - single deck					
	Number	Unit Cost	Cost	Grant	Operator
Diesel replace	68	[redacted]			
Electric bus new	68	[redacted]			
Battery replace	0	[redacted]			
Infrastructure		[redacted]			
		[redacted]			
total		[redacted]			
		[redacted]			
		[redacted]			
Arriva		[redacted]			
Buses - double deck		[redacted]			
		[redacted]			
	Number	[redacted]			
Diesel replace	22	[redacted]			
Electric bus new	22	[redacted]			
Battery replace	22	[redacted]			
Infrastructure		[redacted]			
		[redacted]			
total		[redacted]			
Council					
Operator : Centrebus					
Buses - single deck					
	Number	Unit	Cost	Grant	Council
Diesel replace	6	£ 160,000			
Electric bus new	6	£ 359,000	£ 2,154,000	£ 895,500	£ 1,258,500
Battery replace	6	£ 130,000	£ 780,000	£ -	£ 780,000
Infrastructure		£ 50,111	£ 300,664	£ 225,498	£ 75,166
total			**£ 3,234,664**	**£ 1,120,998**	**£ 2,113,666**
Summary					
Total cost	**Zebra Grant**	**First**	**Arriva**	**Council**	**Total - Local**
£ 47,053,129	**£ 18,996,847**	**£ 15,776,116**	**£10,166,500**	**£ 2,113,666**	**£28,056,282**

11. The table below shows the minimum warranty specification for each project:

Warranties			
	Firstbus	Arriva	Council
	Length (years)	Length (years)	Length (years)
Vehicle	[redacted]	[redacted]	2
Battery	[redacted]	[redacted]	8
Powertrain	[redacted]	[redacted]	5
Structural	[redacted]	[redacted]	12

Increase in Programme Cost since EOI Stage

12. Comparing against the Expression of Interest shows the following differences between total costs, local partner costs and grant:

	Total cost	Zebra Grant	First	Arriva	Council	Total - Local
EOI	£ 39,165,294	£ 16,871,471	£ 15,539,000	£ 5,502,324	£ 1,252,500	£ 22,293,824
FBC	**£ 47,053,129**	**£ 18,996,847**	**£ 15,776,116**	**£ 10,166,500**	**£ 2,113,666**	**£ 28,056,282**
Difference	**£ 7,887,835**	**£ 2,125,376**	**£ 237,116**	**£ 4,664,176**	**£ 861,166**	**£ 5,762,459**

13. The difference in the proposed grant ask since the Expression of interest is detailed in the following tables and described on a project by project basis later in the Financial Case:

Table Redacted

Programme Cost Increase summary		
	Costs	Percentage of Total
Bus cost increase	£ 1,684,000	21%
Infrastructure costs	-£ 320,871	-4%
Additional Scope - buses	£ 1,840,000	23%
Additional Scope - infrastructure	£ 604,706	8%
Battery replacement costs	£ 4,080,000	52%
Total	£ 7,887,835	

Grant Increase summary			
	Costs	**Cost**	**% of total**
Cost increase on EOI estimate :		£ 999,847	47%
Bus	£ 1,240,500		
Infrastructure	-£ 240,653		
Additional scope :		£ 1,125,529	53%
Buses	£ 672,000		
Infrastructure	£ 453,529		
Total	£ 2,125,376	£ 2,125,376	

14. There is also an associated significant increase in the two Operator's and Council's project financial contribution since the EOI stage, shown in the table below.

Reasons for Operator Cost Increase since EOI				
	First	Arriva	Council	Total
Increase in bus price to meet specification	[redacted]	[redacted]	£ 28,500	£ 413,500
Increase in base diesel price (like for like)	[redacted]	[redacted]	£ 30,000	£ 30,000
Additional buses in bid	[redacted]	[redacted]	£ -	£ 1,168,000
Infrastructure cost / scope increase	[redacted]	[redacted]	£ 22,666	£ 70,959
Inclusion of battery replacement costs	[redacted]	[redacted]	£ 780,000	£ 4,080,000
Total	[redacted]	[redacted]	**£ 861,166**	**£ 5,762,459**

15. In summary, the main reasons for the grant increase are due:

   a. The desire for the ZEBRA programme and partners to have higher quality, more accessible buses than originally costed.

   b. There has also been a desire to have batteries with improved battery efficiency management systems to ensure all routes can be achieved throughout the bus life on a single overnight charge. These are now costed into the grant ask.

   c. The ambition of the bus partnership for Leicester, with the desire to invest more than originally set out and move more quickly to a zero carbon bus network.

      - This is associated exclusively with Arriva, who now want to increase frequency on two of the proposed electric bus routes to match complementary Council bus priority and infrastructure investment, together with the predicted increase in demand due to housing and industrial growth on this corridor.

      - As well as increasing overall bus costs, this also requires an associated higher power upgrade to their depot, but no future proofing for significant further expansion at a later date.

Bus Prices

16. The table below shows a summary of the bus prices used in this bid for each project.

Bus Prices						
	FirstBus		Arriva		Council/Centrebus	
	Diesel	Electric	Diesel	Electric	Diesel	Electric
Single Decker	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Double Decker	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

17. The First Bus and Arriva diesel equivalent price is based on their most recent purchase of Euro 6 buses to the nearest specification as the ZEBRA buses, but without the additional enhanced PSVAR specification required for the electric buses.

18. The Council diesel equivalent prices are based on a mid-range of prices for new Euro 6 buses which would meet current council contract specifications, with a similar capacity as the proposed electric buses (Scania and ADL prices for minimum 35 seats)

19. Electric bus prices are based on current quoted costs and recent tenders with given suppliers, with documented quotes for the upgrades to meet ZEBRA enhanced accessibility standards.

20. These may vary following full tendering and supplier evaluation and negotiations. Each partner will take full financial responsibility for any cost overruns above these prices. Any final prices below those shown above will lead to the equivalent grant being returned to the grant administrator and then repurposed or returned to the DfT following engagement.

21. Risk assessment and management of this cost risk is dealt with on a project basis below and within the Management Case. However, it should be noted that:

    a. Each local partner takes full financial risk for its own project's total costs – there is no spread of financial risk between projects/across the programme.
    b. The grant contribution for each project is fixed from the outset and represents about 40% of total costs.
    c. Each operator is meeting around 60% of all costs so has a significant incentive to manage financial and other risk. Their statements of matched funding confirmation are shown in appendix 1 of the Commercial Case.
    d. The City Council – as local grant administrator – will review evidence of all costs incurred as a condition of grant funding. Any savings versus costs shown in this full business case will lead to a matched grant saving which will be retained by the grant administrator, rather than the project owner. Subject to DfT approval, the surplus grant will either be repurposed or returned to DfT.
    e. Grant will be released in stages in line with each project's procurement contracts.
    f. There is comfort in the accuracy of the scheme's most significant costs, with their exact cost subject to finalisation of contractual details.
    g. Those costs that are still subject to procurement and tendering/best value evaluation are estimated on the basis of quotes received to date, previous recent similar purchases and current negotiating positions.

Revenue costs and savings

22. Ongoing work will be taken by each project and finance manager to measure the ongoing additional costs and savings associated with each project:

<u>Additional costs</u>

- Insurance
- Charger maintenance
- Management time
- Additional borrowing costs
- Battery management costs (Zenobe)

<u>Savings</u>

- Fuel difference (after BSOG)
- Bus maintenance costs
- Additional passenger revenue

23. These will be compared with known data for each service currently run using Euro 6 diesel buses.

24. For the contracted service these are currently estimated to be as follows:

Contract operational gross costs per bus per year (£ 000 pa)			
	Diesel	Electric	Difference
Fuel	20.5	12.1	8.5
BSOG	-9.2	-20.5	11.3
Maintenance (bus and chargers)	10.2	5.2	5.0
Insurance	0.0	0.7	-0.7
Depreciation (contractor)	11.7	0.0	11.7
Borrowing costs (council)	0.0	25.7	-25.7
Saving per bus			**10.1**
Total savings pa			**60.5**

[redacted]

[redacted]

27. Redacted

28. It should be noted that each operator is currently purchasing certified renewable energy for each of these projects First and Centrebus REDACTED [redacted], but this is firmly expected to fall significantly once significant numbers are operated. An average of 10.5p kwh is assumed, but cannot be guaranteed for the lifetime of the project. This local rate is therefore used for each project within a sensitivity testing only and is not built into the standard inputs shown in the Economic Case.

Council/Centrebus Project

29. A summary of the capital costs of this project are shown below:

Council/Centrebus Project						
	Unit Cost	Total	2021	2022	2023	2032
Delivery		6		0	6	0
Bus cost - diesel	£ 160,000					
Bus cost - electric	£ 359,000	£ 2,934,000	£ -	£ -	£2,154,000	£ 780,000
Bus Grant	£ 149,250	£ 895,500	£ -	£ -	£ 895,500	£ -
Infrastructure	£ 300,664	£ 300,664	£ -	£300,664	£ -	£ -
Infra Grant	£ 225,498	£ 225,498	£ -	£225,498	£ -	£ -
Total Grant		£ 1,120,998	£ -	£225,498	£ 895,500	£ -
Total Operator		£ 2,113,666	£ -	£ 75,166	£1,258,500	£ 780,000
Total Cost		£ 3,234,664	£ -	£300,664	£2,154,000	£ 780,000

30. As detailed in the commercial case, the Council has very recent experience of purchasing electric buses and associated peripheral and depot equipment, to a very similar specification as is proposed in the bid. This involved purchasing items from nine different suppliers.

31. Detailed discussion has already taken place with these suppliers and all have agreed to in principle to keep their prices broadly unchanged within any similar tender that takes place over the next 12 months.

[redacted]

[redacted]

34. For the ZEBRA proposal, the Council is proposing to replace the battery on expiry, rather than have the additional capital upfront cost of an extended warranty. This means that these additional costs are <u>not</u> subject to 75% grant assistance within the ZEBRA funding period. If these additional costs were included in the upfront purchase price, and subject to grant funding, then the overall grant ask would rise accordingly and the business case BCR fall to an unacceptable level.

35. All suppliers of peripheral equipment – which is purchased directly, since it builds on existing systems – have confirmed that prices will be the same as those quoted for the Greenlines P&R project. This includes making the on-board passenger information screens double sided, to enable viewing from rear-facing seating (including wheelchairs).

[redacted]

37. A summary of the overall project cost estimates is shown in the table below:

REDACTED

[redacted]

39. Additional quotes have now been received for the costs of diesel equivalent buses, raising this from £155,000 per bus to £160,000 per bus. This increases the total cost to the City Council by £30,000, with this increase not grant aided.

40. These additional projected costs include those shown in the table that are above the base tender prices, together with a base cost increase to reflect battery management improvements which will reduce degradation over time. This is an important addition to these buses as given the service's high daily operating mileage.

41. The above costs also represent a £90,664 increase in the additional depot costs required to accommodate these additional buses. This follows a site survey showing the limited space for dual operations at the Centrebus depot – requiring certain costly adaptations to electrical housing, together with the need for a more expensive, more compact, type of charger.

    REDACTED

42. On the basis of this very recent costing work – together with written confirmation from each supplier - it is considered the risk of any significant cost increase is now very low.

43. The financial sustainability of this project and its associated bus service is considered to be strong given the following factors:

    a. The conversion to electric is projected to give an annualised saving over £60,000 p.a., after taking into account borrowing costs. This is set out in more detail in the Commercial Case.

    b. The subsidised 'Outer Orbital' service is strategically well placed to increase its patronage revenue over time given the scale of housing, retail and hospital and other developments taking place along it over the next 15 years.

    c. The associated programme of other capital works already funded and programmed to take place over the next 3 years, to reduce operating costs and improve passenger quality:
        - Bus priority measures and traffic light signal priority
        - Real time information displays
        - Best fare digital capping
        - Improved waiting infrastructure
        - Two new park and ride sites on the route

d. The Greenlines development plans as set out in the current draft Local Transport Plan and associated Workplace Parking Levy consultation. This looks to introduce the following from 2024-2028, with local and bid funding
   - Further bus priority along the outer ring road
   - Double frequency of the service
   - Double the electric bus fleet on the service

e. Proposed introduction of Workplace Parking Levy in 2024. With the levy aimed to be at least the cost of an annual bus pass, this will increase the relative cost of car travel against bus travel. The Nottingham experience of doing this showed a modal shift of around 0.8% from this change (excluding the impact of the levy investment).

44. Given the above, it is also considered that the environmental benefits of the ZEBRA investment will be prolonged and improved over the next 15 years. There is a good chance of replacement electric buses being financed locally thereafter.

45. The service is currently contracted to Centrebus with a net annual subsidy of £187,000 p.a. excluding concessionary fares reimbursement. Pre-covid patronage levels were at 245,000 trips p.a., giving a subsidy per trip of £0.76.

46. As set out in the commercial case, the overall aim of all future investment in this service is to make this service subsidy-free and fully commercial. Investment in ZEBs is seen as a key step towards this goal.

First Bus Project

REDACTED

Arriva Project

47. A summary of the costs of this project are shown below:

REDACTED

48. There were significant discussions with the Council and Arriva before and after the EOI stage in relation to increasing electric bus investment as part of the evolving Enhanced Partnership Scheme, the Council's current and proposed raft of complementary bus investment, and its introduction of Workplace Parking Levy.

49. This led to Arriva's decision to invest early in electric double deckers as part the ZEBRA Fastrack bid on two key corridors where other council investment is taking place.

[redacted]

51. This has now been increased by £10,000 to reflect the additional specification requirements of the ZEBRA bid, particularly in relation to an additional wheelchair and guide dog space, double-sided passenger information screens and AVAS acoustic bus warning system. None of these features are currently on the existing diesel buses on

these routes.

52. This increases the costs for the 18 buses in the EOI by £180,000 – with £135,000 funded by a proposed increase in grant and £45,000 by Arriva.

[redacted]

54. More significantly, in a further development associated with the joint development of a Bus Services Improvement Plan and Enhanced Partnership Scheme (National Bus Strategy), Arriva are now proposing a scope increase in the programme:
    a. A frequency enhancement on these two corridors, requiring a further 4 electric double deckers to meet predicted future demand on these two growing corridors.
    b. Power upgrade and additional cabling and switchgear at their Thurmaston depot to allow for both this expansion, greater operational flexibility and a limited number (8-10) of other electric buses which are likely to also purchased over the next 2-3 years.

55. This increases overall project costs as shown below:

REDACTED

56. It should be noted that power upgrade cost for 22 buses (around 1.4MVA) compared with 2 MVA for around 32 buses is the currently estimated as being the same for this site.

57. Consideration was also given to future proofing the whole depot for future electric bus expansion, by increasing the power upgrade to 3MVA or 4MVA and internal wiring for up to 80 buses. This option cost an additional £350,000 - £450,000 but was considered not viable at this stage due to :
    a. Rapid developments in the electric bus market might alter the future technical specification
    b. Possible use of battery storage and on-site energy generation might alter the need for this upgrade
    c. Contractual inability to reserve all of the additional power with the DNO for more than 2 years.
    d. On site disruption whilst running a 24/7 operations.

58. It is considered that this scope increase is good value for the additional ZEBRA bus grant, since it will be associated and linked with further passenger benefits and modal shift stemming directly with the frequency enhancement it provides.

59. The current mid-range of infrastructure costings is shown below:

REDACTED

60. This scope increase is felt to be good value - both in terms of additional grant requirement and Arriva's additional investment - and being entirely consistent with the objectives of the ZEBRA bidding process:

- Enables two whole AQMA corridors to be converted fully to electric buses, at a higher frequency than at present – improving modal shift along these corridors.

- Increases carbon savings by an estimated 3.6m KG of CO_2.

- Demonstrates the additional investment commitment of Arriva to partnership working, as is directly linked to complementary other investments and policies set out and financed by the Council as part of the existing Bus Quality Partnership work and Enhanced Partnership Scheme planned for introduction in April 2022.

- Significantly beneficial to Leicester's plans for rapidly replace its whole network with electric buses. The depot power upgrade means that Arriva can readily invest in a further 10 electric buses without any additional power supply costs.

- Saves abortive future costs and difficulties in expansion of Thurmaston depot to cater for the additional electric buses likely in over the next 2-3 years. This secures the appropriate power upgrade and is operationally more cost effective.

- Demonstrates the medium term viability of the grant investment, since it is based on catering for an expanding passenger market associated with housing and industrial growth across the conurbation, through additional operating and capital costs by Arriva associated with the expansion.

- Is beneficial in terms of operational change, marketing and ongoing management and maintenance. Without these additional electric buses, these higher frequency routes would need to be operated with a mixed electric/diesel buses.

- Assists in the sustainable development of the south of the conurbation. These routes are expanding to cater for current housing and industrial growth.

- Allows an important frequency increase to assist connectivity to the expanding industrial areas to the south of the City.

- Increases Arriva's commitment to bus investment in Leicester over the next 3 years from £4.5m for diesel buses (originally confirmed as part of the current partnership commitment), to £5.5m in electric buses confirmed at EOI stage, to £10.1m at Full Business Case stage.

61. In addition, including this change also ensures a consistent treatment of operators by giving equivalency of treatment of operators throughout the bidding process. No other local operator in Leicester - other than Arriva and First Bus - has expressed an interest to participate any further in the ZEBRA bidding process since the original EOI consultation process.

62. It is considered that given the above changes, the current project delivery is unlikely to be subject to any further cost escalation.

Risk and Contingency

63. Following significant costing work, suppler discussion and negotiations since EOI stage, it is the view of each project partner (with their own significant stake in this proposed investment) that all costings shown above have sufficient contingency built into them.

64. The bus and infrastructure costs for both the First Bus and Council projects have been drawn up on the basis of firm offer prices from likely suppliers.

65. The Arriva project costs are based on mid-estimates of a range of costings from other similar recent projects and from initial site surveys and cost estimates of Thurmaston depot.

66. All three partners have committed their matching contributions for this programmed into their forward budget plans on basis of these costings. They have each already committed staff resources, together with external costs to technical, surveying and planning consultants to get to this stage of preparation.

67. The ongoing governance of the programme will continuous track spend to budgeted costs for each element within each project. Any overspend of any element will be financed, and is at the risk, of each of the project owners.

68. Any underspend of any project element will look to be recycled within the overall programme through enhanced specification where appropriate in relation to the ZEBRA objectives, but at the agreement of the DfT.

Legal Compliance – Council Project

69. From a legal compliance standing, the proposed ZEBRA capital subsidy for this service has been externally reviewed by DLA Piper and is included at Appendix 1. This sets out advice both at Expression of Interest stage, and then updated for the current Full Business Case stage.

70. The legal advice is that the proposed bid for ZEBRA funding should be capable of implementation consistent with the current UK government position on subsidy control, in particular in compliance with the principles set out in the Trade and Co-operation Agreement between the UK and EU.

71. The risks associated are minimised by the Council ensuring that all operators in the area have had an equal opportunity to apply for funding within the bidding process, and that this funding is then made available to them all on an equivalent basis.

72. DLA has set out additional mitigations for the Council to carry out to minimise the risk of such aid breaching the TCA principles in the future, in particular because a competitive procedure has not been used to allocate limited funding, but rather the funding is being made available on an equivalent basis to all operators.

73. From a procurement perspective, the Council will ensure that the basis upon which it procures secured services which utilise electric vehicles that are Council-owned does not distort competition in the market. The Council will ensure that the vehicles are made available on a non-discriminatory basis to the successful bidder, and that the terms of tendering, and the terms of funding will not provide any bidder with an unfair advantage or distort competition.

74. It should be noted that the buses and chargers remain under the ownership of the Council at all times and are leased to the contractor as part of the operating contract. They can be moved to any other contractor should the contract be re-let to another operator.

75. The operator depot costs associated with cabling and charger installation (only 7% of total project costs) are sunk costs. These are unlikely to be required if the contract was subsequently let to another operator in the future, since by then, each local bus operator will have suitable infrastructure, either from:
    - existing/planned investment – Roberts Travel Group/Stagecoach or
    - ZEBRA investment – Centrebus/Arriva/First Bus

Legal Compliance – Arriva and First Bus Project.

76. From a legal compliance standing, the proposed ZEBRA capital subsidy for these two projects has been externally reviewed by DLA Piper, included at Appendix 1.

77. The legal advice is that the proposed bid for ZEBRA funding should be capable of implementation consistent with the current UK government position on subsidy control, in particular in compliance with the principles set out in the Trade and Co-operation Agreement between the UK and EU.

78. The risks associated are minimised by the Council ensuring that all operators in the area have had an equal opportunity to apply for funding within the bidding process, and that this funding is then made available to them all on an equivalent basis.

Legal Compliance – Mitigations

79. DLA has set out additional mitigations for the Council to carry out to minimise the risk of such aid breaching the TCA principles in the future, in particular because a competitive procedure has not been used to allocate limited funding, but rather the funding is being made available on an equivalent basis to all operators.

80. These mitigations have been, or are being, actioned by the council as follows:

    a. Engaged all local operators in the bidding process from the outset, making the fully aware of the details of the funding opportunity and adequate time to respond. Fully documented all operators’ responses.
    b. Council will act as the local grant administrator to ensure that all expenditure and matched grant is in line with the ZEBRA bidding guidance.

c. Grant will not be made available for any elements of expenditure over and above those agreed through the ZEBRA specification.
d. There will be a transparent process for each operator to receive grant based on actual spend to specification. Any budgeted grant not spent in accordance to the agreed matched percentages will be retained by the Council and repurposed with the agreement of the DfT.
e. No operator will receive grant in excess of 75% of the agreed difference between the price of the electric bus and its diesel equivalent, and no more than 75% of the agreed infrastructure costs.
f. All operators will have equal access to council-owned electric buses and chargers purchased through the ZEBRA scheme when these are used in the operation of contracted tendered services.

81. The procurements carried out by the two commercial operators would be not be subject to regulation 13 of the Public Contracts Regulations 2015. The buses would only be used on exclusively commercial deregulated bus services with no public subsidy. The proposed grants will finance around 40% of overall capital cost of the buses and infrastructure used on these services.

Conclusions and Summary

82. The above sets out the financial scope of Leicester's finalised ZEBRA bid showing:

a. An overall programme value of £47m, with £28m funded locally and £19m funded by grant.
b. An increase in overall cost of £7.89m from the EOI stage, with £2.125m from additional grant and £5.76m from additional local contribution by both the operators and Council.
c. This increase is due to three main factors:
    - Inclusion of battery replacement costs in year 9, fully funded by the operators (52%)
    - An increase in scope of the Arriva element of the programme, from 18 to 22 buses and associated additional infrastructure cost (31%).
    - Bus increases from original estimates (21%) to give enhanced quality and accessibility improvements to all users.

d. The rationale for this increase, the additional benefits it will bring and the increased ambition of the strong partnership.
e. The long term viability of this overall investment across each project.
f. Legal compliance by project in relation to state subsidy.

Appendix 1

External Legal Advice

ADVICE TO LEICESTER CITY COUNCIL IN RESPECT OF ZEBRA BID

Expression of Interest Stage : May 2021

1. Summary of conclusions

1.1 Both Option 1 and Option 2 of the proposed bid for ZEBRA funding should be capable of implementation consistent with the current UK government position on subsidy control, in particular in compliance with the principles set out in the TCA.

1.2 The risks associated with these Options will be minimised by the Council ensuring that all operators in the area have had an equal opportunity to apply for funding within the Bid, and that this funding is then made available to them all on an equivalent basis. We understand that is the case with the current proposed Bid, with both of Options 1 and Option 2 applying for equivalent funding for all commercial bus operator required funding for zero emission buses in Leicester. We have set out additional mitigations in this note that the Council should carry out to minimise the risk of such aid breaching the TCA principles in the future, in particular because a competitive procedure has not been used to allocate limited funding, but rather the funding is being made available on an equivalent basis to all operators.

1.3 From a procurement perspective, the Council will also need to ensure that the basis upon which it procures secured services which utilise electric vehicles that it would purchase under Option 2 does not distort competition in the market. We assume that the Council will ensure that the vehicles are made available on a non-discriminatory basis to the successful bidder, and that the terms of tendering, and the terms of funding under Option 1 will not provide any bidder with an unfair advantage or distort competition. More information on this is set out below.

2. The project and relevant facts

2.1 Leicester City Council (the Council) is preparing a bid to the DfT in respect of ZEBRA Electric Bus Funding ("Bid")

2.2 We have been asked to consider two Options that are being considered for the purposes of the Bid:

Option 1: 86 buses are purchased supported by investment from First Bus and Arriva only. The Council would not invest any of its own capital in these buses. The Council will not separately invest in any buses for its own use.

Option 2: 86 buses are purchased supported by investment from First Bus and Arriva. The Council would not invest any of its own capital in these buses. The Council will purchase a further 6 buses, which will be used for non-commercial contracts let by the Council under which the current contractor provides a diesel bus as part of the contract.

2.3 For the purposes of the assessment Option 1 and Option 2 are therefore the same in respect of investment by First Bus and Arriva. In addition Option 2 includes investment by the Council.

2.4 We understand that the funding grant conditions are that DfT would pay:

75% of the *difference* between the diesel and electric bus prices. We understand that under the Council's proposals 60% of the bus costs will be funded by the operator (or by the Council where they are the operator) and 40% by DfT funding. We assume that this reflects the DfT paying no more than 75% of the difference between

n diesel and electric bus prices

75% of the total cost of any associated charging infrastructure, including power upgrade/civils

2.5 The Council is required to make the bid, with support from relevant bus operators. They are also required to provide a legal compliance statement in respect of subsidy control rules.

2.6 We understand that the Council has engaged with all relevant commercial bus operators in its area to determine the extent to which they would be interested in participating in the Bid. In determining whether they, as operators, wished to invest, consideration has been given to which routes are attractive for use with electric buses at this point in time. This includes taking into account whether they make use of single or double decker buses (as single decker electric buses can currently achieve greater operating mileage on a single charge) which affects the current commercial case for use of double-decker buses. Currently the view is that the technology for double-decker buses is less mature and therefore the business case for commercial investment is reduced.

2.7 Of the commercial operators in Leicester First and Arriva have both expressed an interest in investing in electric buses, in each case as part of a wider EPS with the Council as part of implementing any Bus Service Improvement Plan in accordance with the National Bus Strategy. First Bus have expressed an interest in investing in at least 68 single decker buses. Arriva have expressed an interest in investing in 18 (now 22) electric buses. Stagecoach is already investing in 22 buses, but as part of an existing DfT funded electric bus project in Coventry. Of other commercial operators, Roberts only do contracted work in Leicester, Centrebus have expressed no interest, and Kinch have yet to determine their position.

2.8 We understand that all operators have had an opportunity to determine whether to support the Bid. Option 1 above therefore contains all buses that the commercial bus operators intend to invest in, on the basis of funding available from the DfT. Option 2 also contains all buses that commercial bus operators intend to invest in, and Council investment in their own buses. We would note that the analysis below proceeds on this basis. If any operators have not been provided with an opportunity to contribute to the Bid and/or otherwise have not been included in the Bid on an equivalent basis, this will affect the analysis below.

2.9 For the purposes of this analysis we have considered Option 1 (which covers both Option 1 and the identical commercial element of Option 2) and Option 2A (which covers only the additional local authority element of Option 2).

3. Detail

3.1 Subsidy Control Regime: From 1 January 2021, a new subsidy control regime has replaced the EU State Aid regime that previously applied in the UK. This takes into account both the UK's obligations under free trade agreements with individual companies, the Northern Irish Protocol and the UK's WTO membership. However, it seems unlikely that the proposed funding would be challenged under these arrangements, and the remainder of this note is therefore focussed specifically on the subsidy control provisions under the terms of the EU-UK Trade and

Cooperation Agreement (TCA). Chapter three of Title XI (Level Playing field for open and fair competition and sustainable development) of Heading One (Trade) of Part Two (Trade, Transport, Fisheries and Other Arrangements) of the TCA sets out the provisions relating to subsidy control.

3.2 Is the funding a "subsidy": A "subsidy" is defined in Article 3.1 and has four limbs:

It arises from the resources of the Parties to the TCA;

It confers an economic advantage on one or more economic actors;

it is specific insofar as it benefits, as a matter of law or fact, certain economic actors over others in relation to the production of certain goods or services; and

it has, or could have, an effect on trade or investment between the parties.

3.3 To be a subsidy within the TCA, all four limbs must be satisfied. Applying the limbs in turn:

Limb 1: The funding will be provided by the Council, a public sector body, and is therefore ultimately derived from state resources, **therefore this limb would be satisfied.**

Limb 2: The operators who are funded will obtain an economic advantage as the funding will reduce the costs that they incur in purchasing zero emission buses. Whilst it may be argued that operators do not achieve an advantage, there remains a position that the operators may materially benefit from such investment, including through reduced maintenance and operating costs in the future, and where they have electric charging infrastructure funded through the Bid, their ability to access further electric vehicles without having to make the same upfront infrastructure costs. **Therefore this limb would be satisfied in respect of Option 1. In respect of Option 2A, our understanding is that this will not be the case, the buses will be only used where a contract has been let in accordance with applicable procurement rules and the buses themselves will be purchased through an option tender procedure.**

Limb 3: the funding will benefit certain economic actors over others due to only being available to some operators. Whilst the Council have engaged with all operators in order to determine whether they wish to apply as part of the Bid, and therefore there is an opportunity for all operators to access this funding on an equivalent basis, there is still an argument that Limb 3 is satisfied, as only some operators are accessing the funding, as a matter of fact. This is less applicable to Option 2A, where any operator bidding for the relevant Council contracts would have an equivalent ability to access the relevant buses. **Therefore this limb would be satisfied in respect of Option 1, but not Option 2A.**

Limb 4: whilst there is no substantive guidance on what "effect on trade or investment between the parties" means, the equivalent limb of the EU State Aid regime was always assumed, and there operators in the local transport market, such as Arriva who are active in a number of European markets. It therefore cannot be ruled out that this limb is either satisfied or could be satisfied. **Therefore, whilst it could be argued that this funding being provided in Leicester is unlikely to have an effect on trade with the EU, the more cautious view would be to assume that this limb could be satisfied in respect of Option 1.**

On this basis the funding could be viewed as a subsidy for TCA purposes for the purposes of Option 1 and this note proceeds on that basis. There will not be a subsidy for the purposes of Option 2A. The remainder of this section therefore only considers Option 1.

3.4 Where a subsidy is granted, it must satisfy the six principles (the Principles) set out in Article 3.4 of Chapter 3 of Heading One of Part 2 of the TCA. If the Principles are not met, the subsidy may be challenged by any interested party, which would include competitors to an aided party. The Principles are:

The subsidy pursues a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns ("the objective");

The subsidy is proportionate and limited to what is necessary to achieve the objective;

The subsidy is designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of subsidies being provided;

The subsidy should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy;

The subsidy is an appropriate policy instrument to achieve a public policy objective and that objective cannot be achieved through other less distortive means; and

The subsidy's positive contributions to achieving the objective outweigh any negative effects, in particular the negative effects on trade or investment between the Parties.

3.5 In applying the principles, as they reflect the balancing tests used by the European Commission in assessing notified transactions and for the purposes of the State Aid exemptions under the EU regime, then it remains open to the Council to consider whether such a subsidy would have been compliant with one of the State Aid exemptions or would have been approved upon notification to the EU, as on that basis it is likely to be compliant with the Principles and therefore not vulnerable to a successful challenge. However, it is also possible to simply apply the Principles, as there is not a requirement that there needs to be direct compliance with an existing EU exemption. Note that UK government intends to introduce a more express subsidy control regime in compliance with the TCA, and therefore where more specific rules are introduced by UK government, it may be necessary to revisit this advice to ensure that there is compliance with that regime.

4. Application to Option 1

4.1 **Principle 1**: The ZEBRA scheme sets out a number of public policy aims that it is intended to achieve. This includes understanding the challenges of introducing zero emission buses and supporting infrastructure to inform future government support for Zero Emission Buses, to support roll out of 4,000 Zero Emission Buses committed to by government, and to support the government's commitment to decarbonisation and to reduce the transport sector's contribution to CO2 emissions[1].

4.2 **Principle 2:** The subsidy is limited to cover a proportion of the difference in cost between diesel and electric buses and a proportion of the cost of the additional infrastructure which is necessary for these buses to operate. For this principle to be satisfied it should be demonstrated that the aid granted is the minimum necessary to achieve the objectives. Therefore, the Council

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[1] Paragraph 2.1 Zero Emission Bus Regional Areas scheme – 2021/22 - EOI

should satisfy itself that the aid is covering the net extra cost required to meet the objectives, taking into account any cost savings that the operators will gain from the funding, to ensure that they are not over-compensated.

4.3 **Principle 3:** This will be the case provided it is clear that the operators would not have purchased the electric buses but for this subsidy.

4.4 **Principle 4:** As for Principle 4, it needs to be clear that the funding is only covering costs which the operators would otherwise not have funded i.e. that there is not over-compensation, once any maintenance and operational cost savings have been taken into account.

4.5 **Principle 5:** As far as we are aware there are not other policy instruments in place (such as legislation) which would have the effect of incentivising the Operators to make this investment, nor other funding sources which they could utilise to meet this outcome. On that basis, this appears to be the least intrusive means of achieving the objectives, in particular where this aid is made available on an equivalent basis to all operators applying for it.

4.6 **Principle 6:** As noted above, provided the funding takes into account any wider benefits are derived from the investment to avoid over-compensation, then this principle should be satisfied.

4.7 On the basis of the above, there is a strong argument that the Principles can be satisfied and therefore this subsidy would be consistent with the TCA.

4.8 However, there are some risks associated with this. In particular, our understanding is that the Council is not intending to carry out a specific competitive tender in respect of the provision of this funding, and therefore whilst all operators in the area of the Council have been asked if they wish to participate in the Bid, there remains the potential for an operator to complain at a later date that they were not able to avail themselves of this support, and that this therefore had an impact on competition in the bus market in Leicester. This concern is mitigated by ensuring that all operators have had an equal opportunity to participate in the Bid, and to ensure that they are able to access funding for all vehicles that they wish to upgrade on an equivalent basis, with an equivalent level of financial support.

4.9 As noted above, for a number of the principles to be satisfied, the Council needs to be satisfied that it is not over-compensating the operators. Therefore in putting the Bid forward and then providing the funding to the operators it is important that this is provided on a basis which:

Does not provide more funding that is required to meet the relevant marginal costs of each operator in buying buses (and where the buses vary in specification that the funding contributes to the marginal difference between diesel and electric buses and not other aspects of the specification). For example, the grant funding should not be used to support higher specifications which are not specified by the DfT.

Takes into account any cost savings that the Operators will make as a result of the differing ongoing maintenance and operation costs of electric buses.

Include claw-back provisions to allow for recovery of grant funding to the extent that these principles are not met, to avoid over-compensation.

It will therefore also be important that there is transparency on the costs incurred by operators in purchasing the buses, to ensure that value is achieved. The Council should ensure that there is cost transparency provided in respect of this, including confirmation that the buses have been purchased through a competitive bidding process or application of a competed framework that ensures that the cost of the required subsidy has been minimised, and that the subsidy granted is therefore not aiding the bus manufacturer or operator. There should be transparency on the terms of acquisition, to allow the Council, if required, to be able to confirm that the subsidy is being properly applied.

4.10 Compliance with the above should minimise the risk of the provision of funding under Option 1 not complying with the Principles.

5. Application to Option 2

5.1 As noted above, Option 2 is the same as Option 1, save that there is additional funding provided in respect of buses which will be run as part of Council let services.

5.2 As noted above, the original funding for these vehicles will probably not fall within the definition of a "subsidy" and therefore this funding should be compliant with the TCA.

5.3 This is, however, dependent, upon the Council ensuring that in tendering for services which make use of these buses, all operators have equivalent rights under the tender process. In particular, there will be a need to ensure that there is equivalent access to the ability to maintain and charge such vehicles e.g. through installation of charging equipment and maintenance at a Council owned facility or other non-discriminatory structures for accessing the vehicles and associated maintenance and charging facilities which do not benefit certain operators.

5.4 In particular, care should be taken that the charging facilities funded through the Option 1 funding does not provide those operators with a benefit in tendering for such secured services.

6. Reporting

6.1 Pursuant to the TCA, public authorities are required to evidence that subsidies granted comply with the subsidy control regime. UK Government has published a template document that can be used to evidence compliance, and this is set out in Appendix 1, completed consistent with the analysis in this paper (and on the basis that the mitigations set out in this paper will be implemented if funding is provided).

7. DLA Piper UK LLP

21 May 2021

PUBLIC AUTHORITIES' ASSESSMENT OF HOW INDIVIDUAL SUBSIDIES COMPLY WITH UK-EU TRADE AND COOPERATION AGREEMENT PRINCIPLES

For subsidies in scope of the UK-EU Trade and Cooperation Agreement principles (within the subsidies chapter), public authorities should complete the table below and retain for their records. The information should record how the public authority has complied with the principles in designing their subsidy.

Principles	How does the subsidy comply with the principle?
The subsidy pursues a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns ("the objective").	The ZEBRA scheme sets out a number of public policy aims that it is intended to achieve. This includes understanding the challenges of introducing zero emission buses and supporting infrastructure to inform future government support for Zero Emission Buses, to support roll out of 4,000 Zero Emission Buses committed to by government, and to support the government's commitment to decarbonisation and to reduce the transport sector's contribution to CO2 emissions ("objectives")
The subsidy is proportionate and limited to what is necessary to achieve the objective.	The funding is covering no more than the net extra cost required to meet the objectives, taking into account any cost savings that the operators will gain from the funding, to ensure that they are not over-compensated
The subsidy is designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of the subsidy being provided.	The operators would not have purchased the buses without the subsidy provided.
The subsidy should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.	The funding is covering no more than the net extra cost required to meet the objectives, taking into account any cost savings that the operators will gain from the funding, to ensure that they are not over-compensated

The subsidy is an appropriate policy instrument to achieve a public policy objective and that objective cannot be achieved through other less distortive means.	This appears to be the least intrusive means of achieving the objectives on the basis that there are not other incentives in place for operators to make this investment, or other funding sources that they could utilise. The aid is being made available on an equivalent basis to all operators applying for it
The subsidies' positive contributions to achieving the objective outweigh any negative effects, in particular the material effect on trade or investment between the Parties.	The funding will take into account the wider benefits (for example maintenance cost savings) which derived from the investment to avoid over-compensation.
Where relevant, record consideration against Article 3.5 [Prohibited subsidies and subsidies subject to conditions], including consideration of whether that subsidy has or could have a material effect on trade or investment between the Parties.	The funding does not fall within the prohibited or conditional subsidies listed in Article 3.5 TCA.

Legal Advice Note on Leicester ZEBRA Bid from DLA Piper

Update at Full Business Case Submission Stage

19 August 2021

Summary of conclusions

1. Both Option 1 and Option 2 of the proposed bid for ZEBRA funding should be capable of implementation consistent with the current UK government position on subsidy control, in particular in compliance with the principles set out in the Trade and Co-operation Agreement.

2. The risks associated with these Options will be minimised by the Council ensuring that all operators in the area have had an equal opportunity to apply for funding within the Bid, and that this funding is then made available to them all on an equivalent basis. We understand that is the case with the current proposed Bid, with both of Options 1 and Option 2 applying for funding supporting consistent enhancements for all commercial bus operator required funding for zero emission buses in Leicester. This has included modifying proposals since the EOI stage to ensure that there is a consistent approach to funding (e.g. funding additional buses that form part of the proposed EP). We have set out additional mitigations in this note that the Council should carry out to minimise the risk of such aid breaching the TCA principles in the future, in particular because a competitive procedure has not been used to allocate limited funding between operators, but rather the funding is being made available on an equivalent basis to all operators.

3. From a procurement perspective, the Council will also need to ensure that the basis upon which it procures secured services which utilise electric vehicles that it would purchase under Option 2 does not distort competition in the market. We assume that the Council will ensure that the vehicles are made available on a non-discriminatory basis to the successful bidder, and that the terms of tendering, and the terms of funding under Option 1 will not provide any bidder with an unfair advantage or distort competition. More information on this is set out below.

The project and relevant facts

4. Leicester City Council (the Council) is preparing a bid to the DfT in respect of ZEBRA Electric Bus Funding ("Bid")

5. We have been asked to consider two Options that are being considered for the purposes of the Bid

Option 1: 86 (now 92) buses are purchased supported by investment from First Bus and Arriva only. The Council would not invest any of its own capital in these buses. The Council will not separately invest in any buses for its own use.

Option 2: 86 (now 92) buses are purchased supported by investment from First Bus and Arriva. The Council would not invest any of its own capital in these buses. The Council will purchase a further 6 buses, which will be used for non-commercial contracts let by the Council under which the current contractor (CentreBus) provides a diesel bus as part of the contract.

6. For the purposes of the assessment Option 1 and Option 2 are therefore the same in respect of investment by First Bus and Arriva. In addition Option 2 includes investment by the Council.

7. We understand that the funding grant conditions are that DfT would pay:

   a. 75% of the *difference* between the diesel and electric bus prices. We understand that under the Council's proposals 60% of the bus costs will be funded by the operator (or by the Council where they are the operator) and 40% by DfT funding. We assume that this reflects the DfT paying no more than 75% of the difference between diesel and electric bus prices

   b. 75% of the total cost of any associated charging infrastructure, including power upgrade/civils

8. The Council is required to make the bid, with support from relevant bus operators. They are also required to provide a legal compliance statement in respect of subsidy control rules.

9. We understand that the Council has engaged with all relevant commercial bus operators in its area to determine the extent to which they would be interested in participating in the Bid. In determining whether they, as operators, wished to invest, consideration has been given to which routes are attractive for use with electric buses at this point in time. This includes taking into account whether they make use of single or double decker buses (as single decker electric buses can currently achieve greater operating mileage on a single charge) which affects the current commercial case for use of double-decker buses. Currently the view is that the technology for double-decker buses is less mature and therefore the business case for commercial investment is reduced.

10. Of the commercial operators in Leicester First and Arriva have both expressed an interest in investing in electric buses, in each case as part of a wider EPS with the Council as part of implementing any Bus Service Improvement Plan in accordance with the National Bus Strategy. Arriva have expressed an interest in investing in at least 22 double decker buses. First have expressed an interest in investing in 68 electric single decker buses. Stagecoach is already investing in 22 buses, but as part of an existing DfT funded electric bus project in Coventry. Of other commercial operators, Roberts only do contracted work in Leicester, Centrebus have expressed no interest in commercial investment, and Kinch have yet to determine their position in relation to ZEB type and confirmed they did not want to participate in this funding round.

11. We understand that all operators have had an opportunity to determine whether to support the Bid. Option 1 above therefore contains all buses that the commercial bus operators intend to invest in, on the basis of funding available from the DfT. Option 2 also contains all buses that commercial bus operators intend to invest in, and Council investment in their own buses.

12. We would note that the analysis below proceeds on this basis. If any operators have not been provided with an opportunity to contribute to the Bid and/or otherwise have not been included in the Bid on an equivalent basis, this will affect the analysis below.

13. For the purposes of this analysis we have considered Option 1 (which covers both Option 1 and the identical commercial element of Option 2) and Option 2A (which covers only the additional local authority element of Option 2).

Detail

14. **Subsidy Control Regime**: From 1 January 2021, a new subsidy control regime has replaced the EU State Aid regime that previously applied in the UK. This takes into account both the UK's obligations under free trade agreements with individual companies, the Northern Irish Protocol and the UK's WTO membership. However, it seems unlikely that the proposed funding would be challenged under these arrangements, and the remainder of this note is therefore focussed specifically on the subsidy control provisions under the terms of the EU-UK Trade and Cooperation Agreement (TCA). Chapter three of Title XI (Level Playing field for open and fair competition and sustainable development) of Heading One (Trade) of Part Two (Trade, Transport, Fisheries and Other Arrangements) of the TCA sets out the provisions relating to subsidy control.

15. **Is the funding a "subsidy**"? A "subsidy" is defined in Article 3.1 and has four limbs:

    a. It arises from the resources of the Parties to the TCA;

    b. It confers an economic advantage on one or more economic actors;

    c. It is specific insofar as it benefits, as a matter of law or fact, certain economic actors over others in relation to the production of certain goods or services; and

    d. It has, or could have, an effect on trade or investment between the parties.

16. To be a subsidy within the TCA, all four limbs must be satisfied. Applying the limbs in turn:

    Limb 1: The funding will be provided by the Council, a public sector body, and is therefore ultimately derived from state resources, therefore this limb would be satisfied.

Limb 2: The operators who are funded will obtain an economic advantage as the funding will reduce the costs that they incur in purchasing zero emission buses. Whilst it may be argued that operators do not achieve an advantage, there remains a position that the operators may materially benefit from such investment, including through reduced maintenance and operating costs in the future, and where they have electric charging infrastructure funded through the Bid, their ability to access further electric vehicles without having to make the same upfront infrastructure costs. Therefore this limb would be satisfied in respect of Option 1. In respect of Option 2A, our understanding is that this will not be the case, the buses will be only used where a contract has been let in accordance with applicable procurement rules and the buses themselves will be purchased through on the basis of a competitive procurement.

Limb 3: the funding will benefit certain economic actors over others due to only being available to some operators. Whilst the Council have engaged with all operators in order to determine whether they wish to apply as part of the Bid, and therefore there is an opportunity for all operators to access this funding on an equivalent basis, there is still an argument that Limb 3 is satisfied, as only some operators are accessing the funding, as a matter of fact. This is less applicable to Option 2A, where any operator bidding for the relevant Council contracts would have an equivalent ability to access the relevant buses. Therefore this limb would be satisfied in respect of Option 1, but not Option 2A.

Limb 4: whilst there is no substantive guidance on what "effect on trade or investment between the parties" means, the equivalent limb of the EU State Aid regime was always assumed to potentially apply in such circumstances, and there are operators in the local transport market, such as Arriva, who are active in a number of European markets. It therefore cannot be ruled out that this limb is either satisfied or could be satisfied. Therefore, whilst it could be argued that this funding being provided in Leicester is unlikely to have an effect on trade with the EU, the more cautious view would be to assume that this limb could be satisfied in respect of Option 1.

On this basis the funding could be viewed as a subsidy for TCA purposes for the purposes of Option 1 and this note proceeds on that basis. There will not be a subsidy for the purposes of Option 2A, provided that any operator bidding for the relevant Council contracts does have an equivalent ability to access the relevant buses. The remainder of this section therefore only considers Option 1.

17. Where a subsidy is granted, it must satisfy the six principles (the Principles) set out in Article 3.4 of Chapter 3 of Heading One of Part 2 of the TCA. If the Principles are not met, the subsidy may be challenged by any interested party, which would include competitors to an aided party. The Principles are:

a. The subsidy pursues a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns ("the objective");

b. The subsidy is proportionate and limited to what is necessary to achieve the objective;

c. The subsidy is designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of subsidies being provided;

d. The subsidy should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy;

e. The subsidy is an appropriate policy instrument to achieve a public policy objective and that objective cannot be achieved through other less distortive means; and

f. The subsidy's positive contributions to achieving the objective outweigh any negative effects, in particular the negative effects on trade or investment between the Parties.

18. In applying the principles, as they reflect the balancing tests used by the European Commission in assessing notified transactions and for the purposes of the State Aid exemptions under the EU regime, then it remains open to the Council to consider whether such a subsidy would have been compliant with one of the State Aid exemptions or would have been approved upon notification to the EU, as on that basis it is likely to be compliant with the Principles and therefore not vulnerable to a successful challenge. However, it is also possible to simply apply the Principles, as there is not a requirement that there needs to be direct compliance with an existing EU exemption. Note that UK government intends to introduce a more express subsidy control regime in compliance with the TCA, and therefore where more specific rules are introduced by UK government, it may be necessary to revisit this advice to ensure that there is compliance with that regime.

Application to Option 1

19. **Principle 1**: The ZEBRA scheme sets out a number of public policy aims that it is intended to achieve. This includes understanding the challenges of introducing zero emission buses and supporting infrastructure to inform future government support for Zero Emission Buses, to support roll out of 4,000 Zero Emission Buses committed to by government, and to support the government's commitment to decarbonisation and to reduce the transport sector's contribution to CO2 emissions[2].

20. **Principle 2**: The subsidy is limited to cover a proportion of the difference in cost between diesel and electric buses and a proportion of the cost of the additional infrastructure which is necessary for these buses to operate. For this principle to be satisfied it should be demonstrated that the aid granted is the minimum necessary to achieve the objectives. Therefore, the Council should satisfy itself that the aid is covering the net extra cost required to meet the objectives, taking into account any cost savings that the operators will gain from the funding, to ensure that they are not over-compensated. We understand that the Council is satisfied that this is currently the case on the basis of the additional risks etc. that the operators will be assuming (such as battery replacement costs, charger maintenance etc.).

21. **Principle 3**: This will be the case provided it is clear that the operators would not have purchased the electric buses but for this subsidy. We understand that this is the case.

22. **Principle 4:** As for Principle 4, it needs to be clear that the funding is only covering costs which the operators would otherwise not have funded i.e. that there is not over-compensation, once any maintenance and operational cost savings have been taken into account. We understand that this

[2] Paragraph 2.1 Zero Emission Bus Regional Areas scheme – 2021/22 - EOI

is the case, and the provision of the grant puts the operators in a similar cost position to if they have invested in diesel buses.

23. **Principle 5**: As far as we are aware there are not other policy instruments in place (such as legislation) which would have the effect of incentivising the Operators to make this investment, nor other funding sources which they could utilise to meet this outcome. On that basis, this appears to be the least intrusive means of achieving the objectives, in particular where this aid is made available on an equivalent basis to all operators applying for it.

24. **Principle 6**: As noted above, provided the funding takes into account any wider benefits are derived from the investment to avoid over-compensation, then this principle should be satisfied. As noted above, the Council's assessment currently suggests that this is the case.

25. On the basis of the above, there is a strong argument that the Principles should be satisfied and therefore this subsidy would be consistent with the TCA

26. However, there are some risks associated with this. In particular, our understanding is that the Council is not intending to carry out a specific competitive tender in respect of the provision of this funding, and therefore whilst all operators in the area of the Council have been asked if they wish to participate in the Bid, there remains the potential for an operator to complain at a later date that they were not able to avail themselves of this support, and that this therefore had an impact on competition in the bus market in Leicester. This concern is mitigated by ensuring that all operators have had an equal opportunity to participate in the Bid, and to ensure that they are able to access funding for all vehicles that they wish to upgrade on an equivalent basis, with an equivalent level of financial support.

27. As noted above, for a number of the principles to be satisfied, the Council needs to be satisfied that it is not over-compensating the operators. Therefore in providing the funding to the operators it is important that this is provided on a basis which:

    a. Does not provide more funding that is required to meet the relevant marginal costs of each operator in buying buses (and where the buses vary in specification that the funding contributes to the marginal difference between diesel and electric buses and not other aspects of the specification). For example, the grant funding should not be used to support higher specifications which are not specified by the DfT. We understand that this is currently the case on the basis of current operator proposals, which are based on satisfying the specification required for Zebra only.

    b. Takes into account any cost savings that the Operators will make as a result of the differing ongoing maintenance and operation costs of electric buses. As noted above, the Council's current assessment is that this is the case.

    c. Include claw-back provisions to allow for recovery of grant funding to the extent that these principles are not met, to avoid over-compensation. The Council intends to include this in the grant funding conditions to operators to both ensure that there is claw-back, and also that grant funding will be reduced if costs are lower.

    d. It will therefore also be important that there is transparency on the costs incurred by operators in purchasing the buses, to ensure that value is achieved. The Council should ensure that there is cost transparency provided in respect of this, including confirmation that the buses have been purchased through a competitive bidding process or application of a competed framework that ensures that the cost of the required subsidy has been minimised, or otherwise demonstrate through cost comparison/benchmarking or other methods that the supplier has not been over-compensated or competition otherwise distorted and that the subsidy granted is therefore not aiding the bus manufacturer or operator. There should be transparency on the terms of acquisition, to allow the Council, if required, to be able to confirm that the subsidy is being properly applied.

28. Compliance with the above should minimise the risk of the provision of funding under Option 1 not complying with the Principles.

Application to Option 2

29. As noted above, Option 2 is the same as Option 1, save that there is additional funding provided in respect of buses which will be run as part of Council let services.

30. As noted above, the original funding for these vehicles will probably not fall within the definition of a "subsidy" and therefore this funding should be compliant with the TCA.

31. This is, however, dependent, upon the Council ensuring that in tendering for services which make use of these buses, all operators have equivalent rights under the tender process. In particular, there will be a need to ensure that there is equivalent access to the ability to maintain and charge such vehicles e.g. through installation of charging equipment and maintenance at a Council owned facility or other non-discriminatory structures for accessing the vehicles and associated maintenance and charging facilities which do not benefit certain operators.

32. In particular, care should be taken that the charging facilities funded through the Option 1 funding does not provide those operators with a benefit in tendering for such secured services.

Reporting

33. Pursuant to the TCA, public authorities are required to evidence that subsidies granted comply with the subsidy control regime. UK Government has published a template document that can be used to evidence compliance, and this has been provided to the Council completed consistent with the analysis in this paper (and on the basis that the mitigations set out in this paper will be implemented if funding is provided).

DLA Piper UK LLP

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