EUROPEAN COMMISSION

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In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].		PUBLIC VERSION This document is made available for information purposes only.

Subject: **State aid SA.38788 (2015/N) – United Kingdom**
Compensation to Post Office Limited for costs incurred to provide SGEIs 2015-2018.

Sir,

1. PROCEDURE

(1) On 2 May 2014 pre-notification contacts were established between the Commission and the authorities of the United Kingdom (hereafter "the UK") in respect of future compensation to Post Office Limited (hereafter "POL") for costs incurred to provide services of general economic interest (hereafter "SGEIs") over the period 2015-2018, followed by several exchanges of information.

(2) In parallel, the Commission services have been approached by […][*], a competitor of POL, who raised competition concerns regarding the (allegedly limited) access to POL's network of sub-postmasters on 23 October 2014. The Commission services met with representatives of […] on 9 September 2014 to discuss their concerns. The non-confidential version of this submission was forwarded to the

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UK authorities on 24 November 2014, to which they responded on 11 December 2014.

(3) By SANI notification of 28 January 2015, the UK formally notified compensation to POL for costs incurred to provide SGEIs 2015-2018, registered under number SA.38788.

2. DESCRIPTION

2.1. THE BENEFICIARY

(4) POL is a retail post office company in the UK that provides a wide range of services through its nationwide network of post office branches.

(5) The company is owned by the UK Government through Postal Services Holding Company Limited, which also holds the government's stake in Royal Mail plc (the UK's main postal operator). As part of the Postal Services Act 2011, POL became independent of Royal Mail Group on 1 April 2012.

(6) In 2013/2014, POL's turnover (including the network subsidy payment of £200 million) amounted to £1,179 million. POL reported an operating profit before taxation of £107 million for the same financial year.

(7) POL's nationwide network includes c.11,700 post office branches. At the date of the notification, POL owned and managed directly c.337 (only c.3%) of these post offices ("crowns"). The post offices of the remainder (c.97%) of the network are owned and managed by private operators ("sub-postmasters"), who have entered into agreements with POL to manage a post office ("sub post offices").

(8) POL's on-going programme of network transformation (as of 2012) involves in particular a conversion of traditional sub-post offices and a re-design of the sub-postmaster compensation structure. The network transformation is a central part of the strategic plan that has been agreed between the UK and POL for the period 2013/2014 to 2019/2020. The changes involved in network transformation deliver two immediate benefits, which will equate to a higher standard of quality and cost-efficiency of SGEI delivery by POL. First, post office branch configurations will be more efficient and accessible for SGEI users. Second, the costs incurred by POL in providing the SGEIs will be reduced and made more flexible, making POL more cost-efficient and helping to minimise POL's requirement for UK Government funding.

(9) The business activities of POL (i.e. the services offered by each type of POL's post office branches) are divided into four main categories: (i) mails and retail services; (ii) financial and banking services; (iii) Government services; and (iv) telecoms services. As will be described in section 2.3 below, POL has public service obligations in respect of its delivery of all of these categories except for telecoms services.

2.2. COMMISSION DECISION OF 28 MARCH 2012

(10) On 28 March 2012, the European Commission approved SGEI funding arrangements (of £1,155 million, around €1,390 million[1]) for POL for the period 1

[1] This conversion uses the ECB reference rate on 2 April 2012 of €1 = £ 0.83105.

April 2012 to 31 March 2015 under its decision on case SA. 33054 (hereafter "the 2012 POL Decision").[2] The Commission found the measure to be in line with the 2012 EU Framework for State aid in the form of public service compensation (hereafter "the 2012 SGEI Framework"), in particular because the aid did not exceed the net cost for providing the public service obligations entrusted to POL. This decision also included (in paragraphs 15 and 68) the commitment by the UK to ensure future compliance of all POL's public contracts to provide SGEIs (described in paragraph (13) below) with EU public procurement rules.

(11) The Commission also endorsed the continuation, under stricter conditions, of a working capital facility of up to £1,150 million (around €1,384 million[3]) which would have provided POL with sufficient liquidity to carry out its public service obligations. The Commission concluded that this liquidity facility was provided on market terms and therefore does not constitute State aid within the meaning of Article 107(1) TFEU.

2.3. THE PUBLIC SERVICE OBLIGATIONS ENTRUSTED TO POL

(12) For the next funding period 2015-2018, POL will continue to be entrusted with public service obligations (identical to the ones of the previous funding period) by an entrustment letter dated 23 January 2015 from Jo Swinson MP, the Minister for Employment Relations and Consumer Affairs, to POL (hereafter the "entrustment letter") and a funding agreement dated 27 January 2015, signed between the Secretary of State for Business, Innovation & Skills and POL (hereafter the "funding agreement"). While the entrustment letter imposes on POL the overall obligations to deliver the public service obligations, the funding agreement describes precisely the contractual obligations of the UK and POL (including the precise terms and conditions under which, subject to State aid clearance by the Commission, the funds are made available to POL and shall be repaid in case of overcompensation).

(13) These acts entrust POL with the following public service obligations:

1. To maintain a post offices network above its optimum commercial size that includes at least 11,500 post offices and meets the following minimum access criteria

a. Nationally, 99% of the UK population to be within 3 miles and 90% of the population to be within 1 mile of their nearest post office branch;
b. In urban areas: 99% of the total population in deprived urban areas across the UK to be within 1 mile of their nearest post office branch and 95% of the total urban population across the UK to be within 1 mile of their nearest post office branch;
c. In rural areas: 95 % of the total rural population across the UK to be within 3 miles of their nearest post office branch; and
d. In each postcode district: 95% of the population of each and every individual postcode district to be within 6 miles of their nearest post office branch (establishing a minimum level of coverage at a very local level.

[2] OJ 2012, C 121/01.
[3] This conversion uses the ECB reference rate on 2 April 2012 of €1 = £ 0.83105.

2. To provide the below-listed services (together labelled by the UK as "Product SGEI"), which POL has agreed to make best endeavours to provide to the maximal extent under contracts that have been concluded on a fully commercial basis with a range of public and private bodies, throughout the entirety of this network (see above, point 1):

- Processing of social benefit and tax credit payments to the public;
- Processing of national identity and licensing scheme applications;
- Providing universal payment facilities for public utilities;
- Providing access to postal services under the Mail Distribution Agreement with Royal Mail; and
- Providing access to basic cash / banking facilities and UK Government savings instruments, especially for rural customers and those receiving social benefits.

(14) The so-called network SGEI obligation (hereafter "Network SGEI") concerns the provision of the Product SGEI in those parts of the overall network which go beyond the network required under individual Product SGEI contracts entered into on a commercial basis between POL and the relevant Government department or body (whether public or private).

2.4. UK RESPONSE TO THE COMPETITION CONCERNS RAISED BY […]

(15) […], a competitor of POL, raised concerns about the restricted access to POL's network of sub-postmasters and about the network transformation allegedly involving the exclusion of competitors. In response, the UK takes the view that the network transformation does not involve inducements for a retailer to switch away from a competitor to POL and that the network transformation and POL's restraint policy (i.e. agreements with sub postmasters to offer certain, but not all, of the services provided by POL exclusively on behalf of POL) do not distort competition in a way that is contrary to the interests of the EU.

(16) As regards the network transformation, the UK explains that, insofar as POL makes any investments into a new post office branch these do not constitute an inducement to switch away from a competitor but merely reflect the specific costs faced by POL as a consequence of the additional requirements which distinguish POL's operating model from that of its competitors. In addition, a single post office branch can, and in a large number of instances does, form part of both POL's network and third party networks (see below paragraphs (19)-(20)).

(17) As regards POL's restraint policy, the UK first of all explains that this policy is necessary to enable POL to operate its network efficiently and is justified by objective reasons relating to for example:

- Investment: there is a need to protect POL's initial and on-going investments in infrastructure, support services, brand etc., including from possible free-riding.
- Customer demands: customers (SGEI users) expect a consistent offering from POL nationwide, and as a high quality service is expected, it is important that the incentives of POL and sub-postmasters are closely aligned.

- Client demands: clients (i.e. public or private bodies with whom POL has agreements to offer services throughout their network) often require POL to guarantee consistent service provision at every branch nationwide where their services are offered. Further, some clients require their distributors not to offer competing products. In particular, the restraint is needed as 'mixing' of financial service offerings within one outlet can result in serious regulatory sanctions.

(18) In this context, the UK also explains that since many if not all of its competitors operate similar restrictions, POL might not be able to compete on a level playing field without the restraint.

(19) Furthermore, the UK provides information that the restraint is limited in scope as it does not cover the full bundle of services provided by POL. For example the following services are currently not covered by the restraint:

- […];
- Mobile phone top up and international call card services;
- […];
- […];
- Travel ticket services (classified by the UK as product SGEI);
- […];
- […]; and
- […]

(20) The limited scope of the restraint would mean that in practice sub-postmasters can operate on behalf of POL and competitors simultaneously.

2.5. THE NOTIFIED MEASURES

(21) In the current notification, the UK is seeking approval to provide partial funding for POL's provision of public services for the period between 1 April 2015 and 31 March 2018.

(22) The new funding agreement for POL was signed on 27 January 2015, but will not come into effect until the date of receipt of Commission approval. The funding agreement contains a detailed and precise explanation of the parties' obligations in the delivery of the public services as described above in paragraph (13).

(23) Section 103 of the Postal Services Act 2000 and Section 8 of the Industrial Development Act 1982 each provide a legal basis on which the Secretary of State for Business, Innovation and Skills is able to provide funding to POL. A legally binding agreement to provide funding is set out in the entrustment letter and the funding agreement, and remains conditional on the receipt of approval from the European Commission.

(24) Subject to the receipt of Commission clearance, the UK Government has agreed to provide POL with annual SGEI compensation payments of up to £640 million

(around €859 million[4]) in total, comprising: up to £280 million in 2015/16; up to £220 million in 2016/17; and up to £140 million in 2017/18.

(25) First, the proposed funding (up to £280 million) is intended to compensate POL partially for the normal costs of delivering the Network SGEI under the access conditions specified in the entrustment letter during the period between 1 April 2015 and 31 March 2018 (hereafter 'the new funding period').

(26) Second, the proposed funding is intended to compensate POL partially for the exceptional costs of completing the network transformation described above in paragraph (8) (up to £360 million of a total of approximately £ […] million of investment costs).

(27) The SGEI compensation would be provided to POL across a declining trajectory, and is more than 40% below the POL funding of £1,155 million that was approved by the Commission for the previous funding period.

2.6. THE NET COST CALCULATION OF THE PROPOSED AMOUNT OF SGEI COMPENSATION

(28) The UK has calculated the forecast net cost of the Network SGEI during the new funding period using the 'net avoided cost methodology', as described in the 2012 SGEI Framework.

(29) Broadly, this methodology calculates the SGEI net cost as the difference between the expected net cost for POL when providing the SGEI ("Scenario A") and the expected net cost / profit for POL when operating without any obligation of providing the SGEI ("Scenario B").

(30) ***Scenario A*** is constructed on the basis of POL's forecast income and costs for the new funding period (before public funding), assuming that POL will continue the current SGEI provision under the strategic plan, throughout its current network of 11,700 offices (see above paragraphs (12) to (14)). The assumptions underlying the forecasts are included in the strategic plan and revolve around POL's planned commercial strategy and the related risks and opportunities.[5]

(31) In the counterfactual ***Scenario B***, the alternative commercial strategy for POL (i.e. the optimal commercial strategy once the Network SGEI constraint is lifted) would be as follows:

2.6.1. Changes to the network in Scenario B

(32) POL would maintain an optimal commercial network of […] post offices, as described previously in the 2012 POL Decision. The UK explains that this network size continues to be appropriate in order to achieve the commercial objectives of POL in a scenario where it has no SGEI obligation, including in particular POL's objective to remain Royal Mail's retail partner on the basis that the provision of mail services is central to POL's business model.

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[4] This conversion uses the ECB reference rate on 2 February 2015 of €1 = £ 0.7526.

[5] The two core assumptions in the strategic plan are […]. Beyond these core assumptions, the plan contains a balance of risk and opportunity across income and costs.

(33) The optimal commercial network that would exist in Scenario B would include:

- […] large post offices which are similar in design, configuration and location to the […] post office branches that are currently most profitable for POL; and
- An additional set of […] small post offices, which would enable this optimal network to satisfy Royal Mail's regulatory requirement for access points for postal service users (as determined by the current legal definition of the universal postal service).

(34) The size and distribution of this optimal commercial network would be driven solely by the needs of POL's clients, including (but not limited to) Royal Mail, to obtain a certain level of geographic and population coverage. This network is c. […]% of the size of POL's network today, showing that there is a marked difference between the individual needs of POL's clients, on the one hand, and the public needs reflected by the SGEI requirements identified by the UK, on the other hand.

(35) The financials of this optimal commercial network have been calculated using a gravity model and a financial model, as was previously described in the 2012 POL Decision:

- The gravity model (also known as a spatial interactive model) is an industry-standard model and a way of predicting transaction volumes and demand switch between locations when the network changes. POL has developed a bespoke gravity model that predicts movements by different "product groups" in the context of Scenario B. It calculates the expected impact of the smaller network on POL's transaction volumes and income, and in particular the impact of this on demand and revenue retention rates. The financial inputs used in the gravity model are drawn from information included in the financial model, allowing POL to analyse the impact of different network scenarios, including the counterfactual (i.e. Scenario B), using real-life data on income and demand patterns. Gravity model outputs are validated using measurements from actual past post office branch closures and relocations undertaken by POL.
- The financial model is a complex spreadsheet model that draws detailed financial data for each post office branch from a linked database. This model was developed in around 2007 with the support of […] and has been kept up-to-date by POL since that date.

2.6.2. Changes to the different product categories in Scenario B

(36) POL would continue to provide all five product categories outlined in paragraph (13) across the optimal commercial network in Scenario B. However, the following changes would impact the provision of certain contracts in three product categories (category 1 – social benefit and tax credit payments, category 2 – national identity and licensing scheme applications, and category 5 – access to basic cash / banking facilities and savings instruments):

(37) First, POL would close down its own cash logistics operation and require sub-postmasters to fund the cash requirement of POL services as part of their normal

retail business cash floats. Due to the low cash requirement of POL's services in Scenario B, the UK authorities consider this to be a reasonable assumption.

(38) In Scenario B due to POL closing its cash logistics operation, certain products which have significant cash and cash logistics requirements would be withdrawn, such as the […] contract with the […] under product category […][6], and […] services and […] services to customers under product category […][7]. Combined with the cost savings derived from closing POL's cash logistics operation, the withdrawal of these services would have a net positive impact on POL's financial position. POL's net income would be reduced by around £[…] million through this change but it would also incur £[…] million fewer costs, leading to a net positive effect of £[…] million.

(39) Second, POL would restructure the delivery method under its […] contract that it holds with the […] under product category 2. This would be done because the current contract terms require services to be offered through a physical network that meets certain geographic coverage criteria and comprises […] offices, and POL could not meet the second of these requirements due to its network size in Scenario B. The restructuring of POL's service delivery method would involve POL partnering with a third party to provide the […] service with a network including […] post office branches and […] offices operated by a third party. POL would incur additional costs in the form of one-off costs and on-going costs to establish and maintain such a third party relationship[8]. The overall outcome of this restructuring is that the annual net income and profit generated by POL from product category 2 activities is reduced by around £[…] million in Scenario B.

2.6.3. Income changes in Scenario B

(40) The changes to POL's network income in Scenario B are: (i) consistent with the strategic plan financial forecasts; (ii) based on POL's gravity model and financial model, which estimate the financial impact of changes in customer behaviour; and (iii) take into account the market benefits of a large network, such as brand value and increased footfall.

(41) The £[…] million income that POL is assumed to generate in Scenario B is based on a 3-step analysis, similar to the methodology adopted in the 2012 POL Decision:

- Firstly, POL estimates the income, on a standalone basis, that could be generated by the optimal commercial network needed to meet the strategic requirements of POL and the commercial requirements of POL's major clients. The difference between this income and the income generated by

[6] POL would gain financially from withdrawing from such contracts in Scenario B, although it would retain and continue to seek to win new contracts for all products and services covered by product category […] that can be delivered without a cash logistics operation.

[7] POL would continue to offer services under product category […] to […] (i.e. POL could continue to perform its current contracts with […] without having its own cash logistics operation).

[8] POL has benchmarked its calculation of these costs based on its own previous experience of making similar investments in new post office branches and managing relationships with third parties (e.g. sub-postmasters). The one-off costs would relate to requirements for: (i) new equipment; (ii) training of third party staff; (iii) IT services; (iv) legal services; and (v) project management services. The on-going costs would relate to: (i) per-transactions payments by POL to the third party; (ii) IT services; and (iii) project management services.

POL today is taken to represent the income generated by the post office branches that would not be operated by POL in Scenario B (hereafter "non-commercial post office branches").

- Second, the income generated by the non-commercial post office branches is assumed to migrate to the optimal commercial network in line with assumed retention rates (see in paragraph (43) below). The calculations result in an overall blended retention rate of […]%.
- Third, adjustments to the financials are made to account for the small number of product contracts that would be discontinued (e.g. […]) or restructured (e.g. […]) in Scenario B. POL takes into account any potential impact of these changes on the revenue and costs of the retained activities in the optimal commercial network, although this impact is not considered material.

(42) Following this 3-step process, overall cost and income estimates are then constructed taking into account the size of the optimal commercial network, the mix of income, and the expected scale of network and central functions required.

(43) In order to calculate the retention rates applied in Scenario B, the services that POL offers are grouped into three product categories: (i) leading (i.e. those services where POL is currently the leading retail network distributor); (ii) average (i.e. those services where POL currently has a strong commercial position but where there are active competitors); and (iii) strong competition (i.e. those services where POL currently has a presence but where levels of competition are intense)[9]. Then, POL uses its gravity model to predict retention rates that are likely to be experienced in relation to each of these product categories in Scenario B. These calculations are validated using POL's data and experience from previous closures and relocations of post office branches.

2.6.4. Cost changes in Scenario B

(44) The changes to POL's network costs in Scenario B are of the same nature as those recorded in the 2012 POL Decision. More specifically, the costs that would not be incurred in Scenario B are grouped into four categories: direct costs, shared costs, sustaining costs, and other costs.

Direct costs

(45) Direct costs vary with a change in the volume of a specific output, and can be divided into two broad categories: direct product costs (e.g. variable sub-postmasters' pay); and direct branch costs (e.g. fixed sub-postmasters' pay and staff pay at crown branches). The direct costs that would not be incurred in Scenario B include:

- Variable sub-postmasters' pay in relation to the income that would not be earned by the optimal commercial network;
- Fixed sub-postmasters' pay in relation to the non-commercial post office branches; and

[9] The leading category includes […], for which the retention rate is […]%. The average category includes […], for which the retention rate is […]%. The strong competition category includes […], for which the retention rate is […]%.

- Specific post office branch costs in relation to the non-commercial post office branches (e.g. specialist counter equipment and counter IT, point-of-sale signage and displays, maintenance of security and accessibility, and general fixtures and fittings).

(46) A portion of the direct costs detailed above would still be incurred in Scenario B, as they would still be needed by the optimal commercial network in order to handle the transaction volumes that would migrate from the non-commercial post office branches to the post offices that make up the optimal commercial network.

Shared costs

(47) Shared costs incurred by POL in order to support the branch network (e.g. variable IT system costs and cash supply and logistics costs) vary with a change in the total volume of output, and not directly at the level of post office branches. The shared costs that would not be incurred in Scenario B include those related to the non-commercial post office branches (e.g. IT system costs including terminals, data back-up and storage) and those related to the narrower product set (e.g. costs related to POL's cash logistics operation and the IT capabilities and infrastructure linked to this).

(48) POL has confirmed that the shared costs retained in Scenario B are sufficient to support the size of the optimal commercial network and the volume of transactions assumed to take place.

Sustaining costs

(49) Sustaining costs do not generally vary with a change in the volume of output and include allocated overheads (e.g. fixed IT system costs and central staff costs). The sustaining costs that would not be incurred in Scenario B relate to the central / head office costs linked to the non-commercial post office branches (e.g. telephone helplines for sub-postmasters, product delivery and logistics costs, monitoring and network management services, personnel training, and finance and accounting functions).

(50) POL has confirmed that the sustaining costs retained in Scenario B are sufficient to support the size of the optimal commercial network and the volume of transactions assumed to take place.

Other costs

(51) Other costs are exceptional investment costs, in addition to the three categories mentioned above, for which there would be a reduced need in Scenario B. Firstly, no such costs would be incurred in relation to the non-commercial post office branches which would not operate in Scenario B. Secondly, in relation to the post office branches in the optimal commercial network that would operate in Scenario B, less investment costs would be incurred by POL due to the optimised positioning of that network as compared to POL's current network. For example, in Scenario B POL would incur:

- Low levels of capital expenditure on the maintenance of post offices, because the optimal commercial network would have received sufficient and regular investment over its history; and

- Low levels of investment in network change programmes, because the optimal commercial network would be closer to the optimal position at any given time, reducing the need for costs to change / reconfigure the network.

2.6.5. Conclusion on Scenario B

(52) For the reasons set out above, in Scenario B, POL would only make changes in relation to: (i) the network size (i.e. smaller optimal commercial network of […] post office branches); (ii) the scale of its service offering under product categories 1 and 5 (i.e. withdrawal of services which require POL to maintain its own cash logistics operation); and (iii) the restructuring of POL's […] contract under product category 2, so as to meet a contractual requirement for […]offices.

(53) Table 1 shows the result of the net avoided cost methodology, presenting the estimated income and costs of POL in a scenario with and without the Network SGEI obligation.

Table 1: Net Avoided Cost

		2015/16 (£ mil)	2016/17 (£ mil)	2017/18 (£ mil)	Total (£ mil)
Scenario A with the Network SGEI [11,700 offices]	Income:	[…]	[…]	[…]	[…]
	Costs	[…]	[…]	[…]	[…]
	Net income/(loss)	[…]	[…]	[…]	[…]
Scenario B without the Network SGEI [3,600 offices]	Income	[…]	[…]	[…]	[…]
	Costs	[…]	[…]	[…]	[…]
	Net income/(loss)	[…]	[…]	[…]	[…]
Net Avoided Cost (C=B-A)		[…]	[…]	[…]	[…]
Compensation (D)		**280**	**220**	**140**	**640**
Undercompensation (E=C-D)		[…]	[…]	[…]	[…]

(54) Thus, the total SGEI net cost figure of £[…] million included in Table 1 above represents the cap on the permissible amount of compensation that can be made available to POL in order to discharge its SGEI obligations during the new funding period, in accordance with the underlying assumptions of the strategic plan[10]. However, as explained in paragraph (24) above, the actual amount of SGEI compensation that the UK proposes to make available to POL during the new funding period is significantly less than £[…] million.

3. ASSESSMENT

3.1. EXISTENCE OF AID UNDER ARTICLE 107(1) TFEU

(55) According to Article 107(1) TFEU "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market".

(56) It follows that, in order for a measure to be qualified as State aid within the meaning of Article 107(1) TFEU, the following four cumulative conditions have to be met: i) it has to be imputable to the Member State and granted out of State

[10] See footnote 5.

resources, ii) it has to confer an economic advantage on undertakings, iii) the advantage has to be selective, and iv) the measure has to distort or threaten to distort competition and affect trade between Member States.

(57) In this respect, the Commission first of all notes that the UK accepts the State aid qualification under Article 107(1) TFEU of the notified measure.

(58) In addition, in its 2012 POL Decision (paragraphs 35-45), the Commission noted that the compensation granted to POL for discharging the public service obligations over the period 2013-2015 was selectively advantageous to POL and that it was likely to have an effect on trade between Member States and to lead to a distortion of competition. This assessment regarding the presence of an economic advantage, its selectivity and its impact on competition and trade remains valid for the identical measure (except for the amount) regarding the current funding period for the following reasons:

3.1.1. Aid imputable to the State and existence of State resources

(59) In order to be qualified as State aid, a measure must be imputable to the State and granted directly or indirectly by means of State resources.

(60) The compensation for the delivery of the SGEI is paid by the State from its own budget. Specific acts and agreements between the State and POL form the bases for the granting of this compensation.

(61) Therefore, the compensation granted to POL for the delivery of public services is imputable to the State and is given through State resources.

3.1.2. Selectivity

(62) In order to be qualified as State aid, a measure must be selective.

(63) Since the annual compensation under the funding agreement benefits only one undertaking (POL) and grants additional funds exclusively to that undertaking, this measure is selective.

3.1.3. Economic advantage

(64) To constitute State aid, a measure must confer on recipients an economic advantage.

(65) The Commission recalls that compensations for SGEI granted to a company may not constitute an economic advantage under certain strictly defined conditions. Where the four cumulative *Altmark* conditions[11] are met, public service compensation is deemed not to grant any economic advantage.

(66) In particular, in its *Altmark* judgment, the Court of Justice held that where a State measure must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations, so that those undertakings do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them, such a measure is not caught by Article 107(1) TFEU.

(67) However, the Court also made clear that for such public service compensation to escape qualification as State aid in a particular case, the four cumulative criteria ('*Altmark*-criteria') summarized below must be satisfied:

1. The recipient undertaking must actually have public service obligations to discharge and those obligations must be clearly defined.
2. The parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner.
3. The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit.
4. Where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure, which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means to meet the public service obligations, would have incurred, taking into account the relevant receipts and a reasonable profit from discharging the obligations (hereinafter a "typical undertaking").

(68) In its 2012 POL Decision, the Commission already concluded that this compensation was not *Altmark* compliant. The UK authorities did not provide any new elements in the current notification demonstrating that the compensation for the delivery of the SGEIs by POL respects all *Altmark* conditions nor argue in favour of their fulfilment. In particular, the UK authorities have not provided information substantiating that POL is being compensated according to the costs of a typical well-run undertaking within the sector. In the absence of this information the Commission is not in a position to

[11] Laid down in Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH. See also paragraphs 42 et seq. of the Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ C8, 11.01.2012, p. 4-14.

consider that the fourth *Altmark* condition is met. Therefore, the Commission concludes that the selective measure must be considered as conferring an advantage to POL, which can be qualified as economic advantage within the meaning of Article 107 (1) TFEU.

3.1.4. Distortion of competition and affectation of trade between Member States

(69) In order to be qualified as State aid, a measure must distort or threaten to distort competition and affect trade between Member States.

(70) When aid granted by a Member State strengthens the position of an undertaking compared to other undertakings competing within the internal market, the latter must be regarded as affected by that aid. It is sufficient that the recipient of the aid competes with other undertakings on markets open to competition.[12]

(71) The SGEI compensations granted to POL strengthen its economic situation and therefore threaten to distort competition and are capable of affecting trade between Member States, given that POL operates in sectors that are open to competition. In particular, POL is the largest retailer by outlets in the UK and it provides access to postal services and facilities for banking transactions and payment services. In the postal and financial sectors, competition and intra-Union trade take place either in a direct form originating from other operators providing the same service, including some based in different Member States, or indirectly from other operators providing substitutable services. The measure in question has the potential to distort competition and to impact intra-Union trade in that it is potentially making the entry and the development of other retailers or retail financial services providers in the UK more difficult.

(72) Accordingly, it is clear that any State measure conferring on POL an economic advantage may distort competition within the internal market and affect trade between Member States.

3.1.5. Conclusion on the existence of aid

(73) In light of the above, the Commission concludes that compensation to POL for costs incurred to provide the Network SGEI over the period 2015-2018 involves State aid under Article 107(1) TFEU and will therefore assess its lawfulness and compatibility with the internal market.

3.2. LEGALITY OF THE AID

(74) The Commission takes note of the commitment of the UK to respect the stand-still obligation laid down in Article 108(3) TFEU and not to grant the aid until the Commission reaches a decision authorising the notified measure.

[12] Case C-730/79, judgment of 17 September 1980, Philip Morris / Commission, [1980] ECR, p. 2671, paragraphs 11 and 12, and judgment of 30 April 1998, Het Vlaamse Gewest / Commission, case T-214/95 [1998] ECR, p. II-717, paragraphs 48 to 50. Joined Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98, Mauro Alzetta and others v Commission [2000] ECR II-2319, paragraphs 143-147.

3.3. COMPATIBILITY OF THE AID UNDER THE 2012 SGEI FRAMEWORK

(75) Under certain conditions, Article 106(2) TFEU allows the Commission to declare compensation for SGEIs compatible with the internal market. The 2012 SGEI Framework sets out guidelines for assessing the compatibility of SGEI compensation which exceeds €15 million per year.

(76) The UK accepts that the proposed continuation of (i) the SGEI entrustment and (ii) partial compensation of the forecast SGEI net cost should be analysed as State aid under the 2012 SGEI Framework as in the previous 2012 POL Decision. According to the 2012 SGEI Framework, the following compatibility criteria apply:

3.3.1. Entrustment and duration

(77) An act of entrustment as required under the 2012 SGEI Framework (in paragraphs 15 and 16) is the act which entrusts the provision of an SGEI to the undertaking concerned and should spell out the nature of the task as well as the scope and the general operational conditions of the SGEI.

(78) The entrustment letter and the funding agreement specify POL's obligations in relation to SGEI delivery.

(79) The entrustment letter includes (i) a precise description of the SGEIs, (ii) the methods of calculating partial SGEI compensation and (iii) the procedure that applies for recovering any overcompensation. On receipt of Commission clearance for the proposed arrangements for the new funding period, the entrustment letter will become legally binding.

(80) The funding agreement imposes an obligation on POL to deliver SGEIs meeting the requirements contained in the entrustment letter for the duration of the new funding period and sets out the precise terms and conditions under which, subject to State aid clearance by the Commission, the funds are made available to POL and shall be repaid in case of overcompensation.

(81) According to paragraph 17 of the 2012 SGEI Framework, the duration of the entrustment period should be justified by reference to objective criteria, and in principle should not exceed the period required for the depreciation of the most significant assets required to provide the SGEI.

(82) The entrustment letter provides for POL to be entrusted to provide the SGEIs for an additional period of three years (i.e. the new funding period) which is not to be considered excessive or disproportionate. This duration is aligned with POL's business planning period because:

- the network transformation involves costly investment initiatives which are tailored to POL's SGEI obligations, such that POL needs certainty in relation to the duration of its future SGEI obligations in order to make decisions and deploy funds in an optimal manner;
- the partial nature of the proposed public funding means that accurate cost forecasts are particularly important, and these cannot be reasonably prepared for a shorter or longer period than the duration of the new funding period.

(83) Based on the above-described features of the entrustment letter and the funding agreement, the Commission considers the entrustment and duration criteria of the 2012 SGEI Framework to be satisfied in this case.

3.3.2. Genuine service of general economic interest and public consultation

(84) As indicated in the 2012 SGEI Framework, Member States have a wide margin of discretion regarding the nature of services that could be classified as being SGEIs. The Commission's task is to ensure that the margin of discretion is applied without manifest error as regards the definition of an SGEI.

(85) The Commission first of all notes that the entrustment letter delineates a separate Network SGEI mission and ensures that the compensation paid is sufficiently ring-fenced to finance exclusively the Network SGEI and not the delivery as such of the services together labelled by the UK as Product SGEI which are financed according to the terms of the commercial contracts between POL and its public or private counterpart.

(86) As regards the Network SGEI, the Commission notes that the public service obligation of POL to maintain a post offices network above its optimum commercial size and to provide a bundle of services through that network has already been recognised by the Commission as a genuine SGEI in the 2012 POL Decision.

(87) Furthermore, the qualification of the Network SGEI entrusted to POL as SGEI is justified by the UK with regard to a number of public needs:

- First, the public requires a customer service for the provision of public services to be available in a local, accessible and secure serviced office environment. This requirement arises in particular because certain people (e.g. including the vulnerable, elderly, rural dwellers and deprived urban dwellers) cannot travel independently for long distances and/or cannot easily access the internet or telephone services.
- Second, the public has a requirement for local serviced offices to offer a bundle of key services; the convenience of being able to complete a range of transactions in the same post offices is highly valued, in particular because retail areas are widely dispersed and public transport links are irregular in many parts of the UK.
- Third, the UK recognises a social policy requirement for the SGEIs, with post offices being a key part of the social fabric of communities as post offices foster social and territorial cohesion, and improve community life. These social effects of the public services are especially important in an era where an ever-increasing proportion of public communication is made through digital means, which cannot be accessed easily by certain segments of the UK population.

(88) According to the information provided by the UK, the above-described public need for the Network SGEI would not be met under normal market circumstances. The dispersed nature of the UK population and the costs of meeting relevant standards mean that a commercially optimal network of serviced offices would not have a wide geographic coverage and might not be of a sufficiently high quality to meet the public needs.

(89) Based on the above, the Commission considers that the Network SGEI does constitute a genuine SGEI and that the UK has not committed a manifest error in its definition.

(90) In addition, according to paragraph 14 of the 2012 SGEI Framework, Member States should show that they have given proper consideration to the public service needs supported by way of a public consultation or other appropriate instruments to take the interests of users and providers into account.

(91) The public need for these Network SGEI entrusted to POL, as required by paragraph 14 of the 2012 SGEI Framework, was validated by a public consultation in 2007 on network access requirements and the findings of an independent study by NERA competition economists in 2009 on the social value of POL's network. In addition, POL and independent parties, including the National Federation of SubPostmasters and Citizens Advice (in 2014), have undertaken a number of research projects since 2009 which offer evidence to support the conclusions of the 2007 public consultation on network access requirements and the 2009 study by NERA on the public need for and the social value of POL's network.

(92) The Commission also notes that the UK commits in the notification to complete a new public consultation on the public need for the SGEIs entrusted to POL before seeking approval for any future funding of POL beyond the new funding period.

(93) Based on this, the Commission can conclude that the obligation to carry out a public consultation on public needs to define the SGEI has been met for the period covered by the current notification.

3.3.3. Compliance with Directive 2006/111/EC[13]

(94) According to paragraph 18 of the 2012 SGEI Framework, "aid will be considered compatible with the internal market on the basis of Article 106(2) of the Treaty only where the undertaking complies, where applicable, with Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings."

(95) The UK confirms that the financial relations between POL and the UK, pursuant to the proposed measures for the new funding period, are transparent as required by Articles 1(1) and 3 of the Transparency Directive (2006/111/EC). Public funds provided to POL and the use made of these public funds by POL will continue to be identified clearly in POL's published statutory accounts, as well as in the published annual report of the Department for Business, Innovation and Skills of the UK.

(96) In addition, POL will continue to prepare statutory accounts that meet International Accounting Standards, as well as the requirements of Article 1(2) and Article 4 of the Transparency Directive. POL will prepare SGEI accounts each year which will be verified by an independent financial advisor.

(97) Furthermore, the UK will continue to ensure that information concerning its financial relations with POL is kept at the disposal of the Commission for the time

[13] OJ L 318, 17.11.2006, p. 17.

period specified in Article 6 of the Transparency Directive, for a minimum duration.

(98) For these reasons, the Commission considers that POL complies with Directive 2006/111/EC.

3.3.4. EU Public Procurement Rules

(99) Paragraph 19 of the 2012 SGEI Framework makes the compatibility of SGEI compensation conditional upon compliance with Union public procurement rules, where applicable.

(100) The Network SGEI, based on the entrustment letter and the funding agreement, qualifies as a public service contract which in principle falls within the scope of the EU Public Procurement Directives. However, in its 2012 POL Decision, the Commission has accepted that, at the time, POL was the only operator whose network and contractual relationships actually satisfy the requirements for the provision of the Network SGEI, as described in the entrustment. In these circumstances, the Commission considered that the negotiated procedure without prior publication, which is followed to entrust POL with the Network SGEI, was justified under EU public procurement rules

(101) As regards the next funding period, according to the UK, POL remains the only possible provider of the Network SGEI because no other physical network operator present today in the UK meets the UK's needs. This view is based on the following special characteristics of POL, in particular:

- The ability to meet the UK Government's requirements for the network, including its size and density and certain quality characteristics that the UK argues are needed to meet the expectations of public service users.
- POL's wide physical network being unique because the dispersed nature of the UK population means that a commercially optimal network would largely be located in densely populated urban areas and would also not meet the aforementioned quality characteristics.
- POL being the only network operator that fulfils the quality and capacity needs of the UK Government.
- The ability to provide a bundle of public services through a single cohesive and high-quality network of offices; and
- The ability to perform an important social and economic role across the UK (in particular in rural and urban deprived areas) as POL post office branches are relied upon by many people, including vulnerable groups, as sources of information and advice on public services.

(102) Based on the above elements, the Commission concludes that POL remains in a unique position of being able to provide the Network SGEI and can therefore be covered by the sole provider exemption and be entrusted through a negotiated procedure without prior publication according to Article 31 (1) (b) of Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on

the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts.[14]

(103) In addition, the 2012 POL Decision (in paragraph 15) endorsed the UK commitment to ensure, in the future, the compliance of all POL's public contracts to provide Product SGEIs with European Union public procurement rules in the light of the link between the delivery of the Product SGEI services and the Network SGEI. The UK also informed the Commission at that time that, if it would decide to extend the POCA contract when it expires in March 2015 at the latest, it will do so in full compliance with the applicable Union rules on public procurement.

(104) In this respect, the Commission notes that the UK Government has in the past complied with the above commitment and has renewed this commitment for the future. In that context, the UK has provided a contract review covering all public Product SGEI contracts which are subject to the European procurement Directives[15] because they were (i) concluded between POL and a contracting authority that is subject to public procurement rules and (ii) have an aggregate value in excess of the relevant threshold (the lowest being £111,676).

(105) This review shows in particular that these contracts were:

- either tendered by the relevant contracting authority in a manner compliant with EU public procurement rules[16]
- or covered by the sole provider exemption and therefore the negotiated procedure without prior publication was justified under EU public procurement rules[17]
- or awarded prior to the coming into force of the relevant EU public procurement Directives and where the UK has committed that in mid-2015 it will launch a tendering procedure (namely, in respect of the contract that Merseytravel holds with POL for ticketing services).
- or will not be extended in its current form after March 2015 (the POCA contract), but instead has been awarded as a call-off contract[18] to POL based on a framework agreement (FOCS) which was tendered in compliance with EU public procurement rules. [19]

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14 OJ L 134, 30.04.2004, p. 114.

15 Directives 2014/23/EC, 2014/24/EC and 2014/25/EC, or their predecessors Directives 2014/17/EC and 2004/18/EC, if applicable.

16 Including the contracts relating to (i) the Sale and processing of fishing rod licences for the Environment Agency; (ii) Biometric data capture for the UK Border Agency; (iii) Travel ticket Services for transport to London; (iv) Front Office Counter Services (FOCS) framework (iv) the Driver Licence and Motor Tax Applications Services for DVLA (v) Passport check & send services for Her Majesty's Passport Office (the latter two were advertised as part of the procurement of the FOCS Framework).

17 That is to say (i) the contract relating to the sale and processing of Premium bond applications for national savings and investments, POL being the sole provider for over-the-counter services and (ii) the Master Distribution Agreement with Royal Mail (consistent with Article 40(3)(c) of Directive 2004/17 and, by extension, therefore also Article 31(1)(b) of Directive 2004/18/EC).

18 A call-off contract is used for the supply of specific goods or services subject to the specifications, terms and conditions agreed under the umbrella of a framework agreement.

19 See footnote 16.

(106) In light of the above, the Commission is satisfied that the EU public procurement compliance criterion under paragraph 19 of the 2012 SGEI Framework is met in this case.

3.3.5. Absence of discrimination

(107) According to point 20 of the 2012 SGEI Framework, "[w]here an authority assigns the provision of the same SGEI to several undertakings, the compensation should be calculated on the basis of the same method in respect of each undertaking". As the SGEI's at issue are exclusively assigned to POL, the Commission considers that there cannot be a question of discrimination in the sense of point 20 of the 2012 SGEI Framework.

3.3.6. Amount of compensation and verification of the absence of overcompensation

Amount of compensation and the net avoided cost methodology

(108) According to paragraph 21 of the 2012 SGEI Framework, "the amount of compensation must not exceed what is necessary to cover the net cost of discharging the public service obligations, including a reasonable profit."

(109) According to paragraph 24 of the 2012 SGEI Framework, "the net cost expected to be necessary to discharge the public service obligations should be calculated using the net avoided cost methodology where this is required by Union or national legislation and in other cases where this is possible."

(110) According to paragraph 25 of the 2012 SGEI Framework, "under the net avoided cost methodology, the net cost expected necessary to discharge the public service obligations is calculated as the difference between the net cost for the provider of operating with the public service obligation and the net cost or profit for the same provider of operating without that obligation. Due attention must be given to correctly assessing the costs that the service provider is expected to avoid and the revenues it is expected not to receive, in the absence of the public service obligation. The net cost calculation should assess the benefits, including intangible benefits as far as possible, to the SGEI provider."[20]

(111) The proposed amount of SGEI compensation for the new funding period can be shown not to exceed the net cost of SGEI delivery, based on the net avoided cost methodology. As described in detail in section 2.6 above, this methodology has been implemented in accordance with the requirements of the 2012 SGEI Framework by calculating: (i) the net cost of POL operating with an obligation to deliver the Network SGEI (Scenario A); (ii) the net cost or profit of POL operating without the SGEI obligation (Scenario B); and (iii) the difference between the financials of Scenario A and Scenario B (the SGEI net cost).

(112) The calculations for Scenario A are based on POL's actual final projections, and the underlying assumptions specified in the strategic plan. These assumptions are

[20] Annex I to Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008 amending Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services contains more detailed guidance on how to apply the net avoided cost methodology.

based on plausible and observable parameters concerning the economic environment in which the SGEI is provided, as described in paragraph (30).

(113) The calculations for Scenario B follow the principles below, which are similar to those accepted by the Commission in previous cases[21]:

1. An optimal commercial strategy is developed for POL. In this respect, after considering whether it would be commercially rational for POL to continue its current activities in Scenario B, POL concluded that it would make the following changes: (i) reduce the size of its network to […] post office branches; (ii) reduce the scope of certain of its activities; and (iii) restructure its contract with […].

2. A financial picture of Scenario B is constructed based on knowledge of market conditions and POL's accounting system and, where changes are included in Scenario B, costs remain allocated to specific products on the basis of reliable cost-drivers. As described in detail in section 2.6 above, the financial impact of POL's strategy under Scenario B has been calculated on the basis of POL's accounts and its relevant experiences (e.g. closures of post office branches and relocations, termination and restructuring of contracts). Moreover, costs are allocated to specific products using the same methodology in Scenario A and in Scenario B.

3. All necessary measures are taken to avoid double-counting[22] in the overall financial picture for Scenario B. The financial calculations carried out by the UK authorities are similar to those approved in the 2012 POL Decision, and are consistent with POL's accounting system and cost allocation methods. Furthermore, they have been verified by an independent financial adviser.

4. The methodology takes into account all cross-effects (e.g. the impact of changing one aspect of POL's business on a separate aspect of POL's business). Since POL would maintain in Scenario B the same price and quality of the service as today, the risk of cross-effects is low. However, the relevant cross-effects are taken into account:

   - Following a review of POL's commercial contracts as regards any network size requirement, it was concluded that the optimal network as maintained in Scenario B would allow POL to retain almost all of its current contracts. Specifically, this exercise identified only one contract, between POL and […], whose current terms could not be met due to the reduced size of the optimal commercial network. As described in paragraph (39) above, this issue has been addressed by restructuring the […] contract in Scenario B.

   - The closure of POL's cash logistics capability has also been considered in constructing Scenario B and relevant financial estimates - both in respect of income and costs - have been adjusted accordingly. This includes not

[21] See, for example, the Commission's decision of 2 May 2013 in case SA.31006 on State compensation to bpost for the delivery of public services over 2013-2015.

[22] There is no risk of double-counting, as Scenario B has been constructed in a way that ensures each line of income, and the costs incurred by POL in generating that income, are all recorded only once. More specifically, by linking each line of income and cost in the counterfactual scenario to a line of income or cost recorded by POL today, the risk of double-counting is mitigated.

only making adjustments to reflect the withdrawal of the cash logistics operation itself, but also: (i) the impact of POL stopping to provide certain services that constitute a direct requirement for the withdrawn operation (e.g. POCA, business banking, ATMs and third party cash provisioning services); and (ii) the impact of stopping these services on other areas of POL's income and costs.

(114) In light of the above, it can be considered that the net avoided cost methodology implemented by the UK authorities is robust and in line with paragraphs 21-32 of the 2012 SGEI Framework.

Reasonable profit

(115) In the counterfactual scenario, POL achieves a net income of £[…] million for sales of £[…] million, meaning a 6.4% Return on Sales (hereafter "ROS"). This rate is in line with rates of return on SGEI of previous Commission decisions on POL[23]. It can also be observed that PayPoint, which is POL's main competitor for bill payment services, earned a ROS of 18.68%[24] in 2011. Finally, although it appears difficult to identify a comparable undertaking in view of all SGEI activities performed by POL, it can be noted that the profit level assumed by POL in Scenario B is well in line with previous estimations used by the Commission[25].

(116) Therefore, it can be considered that the resulting profit figure in Scenario B is not excessive.

Efficiency incentives

(117) According to paragraphs 39-43 of the 2012 SGEI Framework, Member States have to include efficiency incentives in their compensation mechanisms. In this respect, "efficiency incentives can be designed in different ways to best suit the specificity of each case or sector. For instance, Member States can define upfront a fixed compensation level which anticipates and incorporates the efficiency gains that the undertaking can be expected to make over the lifetime of the entrustment act. Alternatively, Member States can define productive efficiency targets in the entrustment act whereby the level of compensation is made dependent upon the extent to which the targets have been met."

(118) The Strategic Plan includes annual efficiency milestones. Since the funding agreement and the entrustment letter impose specific SGEI delivery requirements on POL, efficiency cannot be achieved at the expense of quality. The efficiency incentives are precise and targeted and take, in particular, the form of annual

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23 7.3% ROS was taken into account in the 2012 POL Decision, 12.5% in the Commission decision of 7 March 2007 in case N 822/2006 Debt payment funding to POL, OJ C 80, 13.04.2007, and around 7% in the Commission decision of 28 November 2007 in case N 388/2007 POL Transformation Programme, OJ C 14, 19.01.2008.

24 Source: PayPoint Annual Report for the year ended 27 March 2011, which can be found online at http://www.paypoint.co.uk/sites/default/files/images/inline/files/PayPoint%20plc%20Annual%20Report%202011.pdf.

25 See, for example, the Commission's decision of 25 January 2012 in case SA.14588 on Measures in favour of De Post-La Poste (now bpost), and the Commission's decision of 1 August 2014 in case SA.35608 on Compensation for the financing of the universal postal service in Greece.

funding milestones[26] that are a pre-condition to the UK Government's release of the annual SGEI compensation payments to POL. In order to achieve these milestones against a declining profile of SGEI funding, POL must increase the efficiency of its operations, not only in relation to its physical network, but also in respect of the income that network is able to generate and the level of costs it incurs. Details of the actions that POL is proposing to take to meet commercial and financial targets will be set out in yearly implementation plans. In the event that POL does not meet some of the targets set out in an implementation plan, it is required to include details of mitigating actions being taken in subsequent implementation plans.

(119) This shows that the UK has clear structures in place to ensure that the funding milestones, as outlined above, and the more detailed activities that need to be undertaken in order for POL to achieve them, are monitored closely.

(120) Moreover, there is an incentive effect stemming from the fact that POL is only partially compensated, as POL can retain efficiency gains achieved on the difference between the total amount of State compensation and the expected net costs of POL over the entrustment period.

(121) In fact, even though POL is obliged to repay excess compensation to the UK beyond the net costs of the service which include a reasonable profit, POL is likely to be incentivised to increase its efficiency. The reason is that POL will receive a fixed upfront compensation that is below the expected net costs of the SGEI. Taking into account the State compensation, POL is expected to make a loss in real terms (£640 million - £[…] million = - £[…] million) corresponding to a (-[…]%) Return on Sales over the entrustment period. POL is however allowed to keep efficiency gains as long as it is not overcompensated according to the Net Avoided Cost methodology. Since POL is undercompensated by £[…] million, it could keep up to that amount of efficiency gains over the entrustment period which would allow the operator to reach a profit level of (£[…] million - £[…] million = £[…] million) corresponding to a […]% Return on Sales (£[…] million / £[…] million).

(122) Based on the above, it can be considered that the entrustment letter contains sufficient efficiency incentives for the provision of the Network SGEI.

Separation of accounts

(123) According to paragraph 44 of the 2012 SGEI Framework, "[w]here an undertaking carries out activities falling both inside and outside the scope of the SGEI, the internal accounts must show separately the costs and revenues associated with the SGEI and those of the other services […]. Where an undertaking is entrusted with the operation of several SGEIs because the granting authority or the nature of the SGEI is different, the undertaking's internal accounts must make it possible to verify whether there has been any overcompensation at the level of each SGEI."

[26] These milestones relate to: (i) POL continuing to meet certain requirements in respect of the physical network's size and scope (for example, POL has committed to achieve a greater than […]% reduction in its central costs between now and 2020); (ii) POL providing the UK Government with an implementation plan each year, setting out the steps that it will take in respect of the strategic plan for that year; and (iii) POL providing the UK Government with relevant SGEI statements, as described in paragraph (128).

(124) The UK has confirmed that the notified measures will be implemented in accordance with these provisions. In particular, POL's internal accounts will be structured so as to distinguish between SGEI and non-SGEI financials (i.e. net income and costs), and to make it possible to verify that there has been no over-compensation.

(125) As detailed in section 3.3.3 above, POL prepares statutory accounts that meet International Accounting Standards and it will prepare SGEI accounts each year, which will be verified by an independent financial advisor.

(126) Therefore, it can be considered that POL complies with the requirement for separation of accounts.

Absence of overcompensation

(127) As shown in Table 1 above, the proposed SGEI compensation payments to be made to POL are about […]% less than POL's forecast SGEI net cost. Therefore, there is no prospect of any overcompensation of POL over the new funding period.

(128) In addition, in the funding agreement, the UK Government has provided for the following strict safeguards for the avoidance of overcompensation:

- POL must provide the Secretary of State, within three months of signature of POL's accounts in respect of each financial year, with a financial statement of the SGEI net cost incurred in POL's most recent financial year, and of the cumulative amount of SGEI net cost incurred by POL since 1 April 2015. This statement must also include a clear explanation of how the amounts have been calculated, as well as a confirmatory statement from an independent firm of financial advisers. In addition, this statement may also be further verified by an accountancy firm appointed by the UK where this has been requested by the Secretary of State.
- If POL's total SGEI net cost proves to be less than the total amount of SGEI compensation that POL has been given during the new funding period, then POL is required to refund the difference to the Secretary of State following 31 March 2018.
- POL may only use the public funding to meet the direct and indirect costs associated with its provision of the Network SGEI.
- The UK Government has decided that the income generated from POL's non-SGEI activities shall contribute to the financing of the SGEIs entrusted to POL. These activities therefore reduce the SGEI net cost and any risk of overcompensation.

(129) In view of the above, it can be concluded that the UK has taken sufficient measures to closely monitor POL's funding over the new funding period and to prevent any overcompensation of POL from arising.

(130) In conclusion, the Commission is satisfied that the amount of compensation is in compliance with section 2.8 of the 2012 SGEI Framework.

3.3.7. Potential additional remedies to avoid undue distortion

(131) Paragraphs 51 et seq. of the 2012 SGEI Framework, and in particular paragraph 59, provide for additional requirements in exceptional circumstances where the aid is likely to give rise to serious competition distortions and to affect trade to such an extent as would be contrary to the interest of the Union.

(132) The Commission would first of all like to recall that fulfilment of the other requirements set out in the Framework is usually sufficient to ensure that the aid does not distort competition in a way that is contrary to the interests of the Union.

(133) Furthermore, as regards the competition concerns raised by […], the Commission considers that the network transformation as well as POL's restraint policy do not distort competition in a way that is contrary to the interests of the Union.

(134) In this respect, the UK has demonstrated that the network transformation does not involve inducements for a retailer to switch away from a competitor to POL by its clarifications that POL's investments in a new post office branch do not act as inducements for a retailer to switch away from a competitor to POL, but that such investments rather reflect the cost of the requirements which distinguish POL's operating model from that of its competitors (see also paragraph (16) above).

(135) Furthermore, as regards POL's restraint policy, the UK has convincingly explained that this policy is necessary to enable POL to operate its network efficiently and is justified by objective reasons relating to the protection of investments and customer, client and sub-postmaster demands (see paragraph (17) above). Furthermore, since many if not all of its competitors operate similar restrictions, POL would likely not be able to compete on a level playing field without the restraint (see paragraph (18) above).

(136) The UK has also clarified that the restraint is limited in scope as it does not cover the full bundle of services provided by POL (see paragraph (19) above) and that this limited scope of the restraint means that in practice sub-postmasters do operate on behalf of POL and competitors simultaneously at least for a range of services (see paragraph (20) above).

(137) Moreover, the UK has made a network access commitment to allow for competitor access to POL’s network in circumstances where it is demonstrated that no alternative outlet exists in a particular geographic area of the UK. This commitment entails that, upon receipt of a written request from a provider of a service that competes with a Product SGEI, which demonstrates that no contact point other than a POL post office branch can be used by customers of the relevant service in a particular postcode district, POL shall grant access to its network to that provider, provided that it would not (i) materially impede POL’s ability to provide the SGEIs entrusted to it; (ii) be prejudicial or detrimental to POL’s brand or positioning; or (iii) be inconsistent with the regulatory obligations of POL or its commercial partners. POL will apply transparent, consistent and efficient procedures in the context of this network access commitment and the UK will supervise the application of this commitment, making sure that sufficient resource is allocated to this function within POL and that appropriate governance, implementation, reporting, information sharing and escalation procedures are in place (i.e. ones which are transparent, consistent and efficient).

(138) This commitment that provides for operators offering services that compete with POL's Product SGEIs to access POL's network will mitigate any risk of foreclosure.

(139) The Commission considers that the clarifications and commitment given ensure that exceptional circumstances that would require imposing additional conditions are not present.

3.3.8. Transparency

(140) Paragraph 60 of the 2012 SGEI Framework states that for each SGEI compensation falling within the scope of this Communication, the Member State concerned must publish the following information on the internet or by other appropriate means:

a. The results of the public consultation or other appropriate instruments referred to in paragraph 14;

b. The content and duration of the public service obligations;

c. The undertaking and, where applicable, the territory concerned;

d. The amounts of aid granted to the undertaking on a yearly basis.

(141) In their notification, the UK ensures compliance with this requirement by making publicly available the following information regarding the proposed measures:

- The results of all public consultations on the public need for the SGEIs (including the new public consultation that the UK Government has committed to undertake);
- The content and the duration of the entrusted SGEIs;
- The undertaking and territory concerned with/by the provision of the entrusted SGEI; and
- The amounts of SGEI compensation to be granted to POL on an annual basis.

(142) The UK has also confirmed that it will report to the Commission on the compliance of all SGEI entrustments with the 2012 SGEI Framework at two years intervals in accordance with point 62 of the 2012 SGEI Framework.

3.3.9. Conclusion on the compatibility with the internal market

(143) The notified measure being in line with the conditions set out in the 2012 SGEI Framework, it is compatible with the internal market.

4. DECISION

(144) The Commission is pleased to inform the UK that, having examined the information supplied by your authorities on the measures referred to above, the State compensations granted to Post Office Ltd for the delivery of the public services over the period 2015-2018 constitute State aid compatible with the internal market pursuant to Article 106 (2) of the TFEU.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm.

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State aid Greffe
B-1049 Brussels
Belgium
Fax No: +32 2 2961242

Yours faithfully,

For the Commission

Margrethe VESTAGER
Member of the Commission