EUROPEAN COMMISSION

Brussels, 20.2.2018
C(2018) 954 final

In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, 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. 48224 (2018/N) – United Kingdom

Compensation to Post Office Limited for costs incurred to provide SGEIs 2018-2021.

Sir,

1. PROCEDURE

(1) On 15 May 2017 pre-notification contacts were initiated between the Commission and the authorities of the United Kingdom (hereafter "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 2018-2021.

The Rt Hon Boris JOHNSON
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(2) By SANI notification of 03 January 2018, the UK formally notified compensation to POL for costs incurred to provide SGEIs over the period 2018-2021, registered under number SA. 48224 (2018/N).

2. DESCRIPTION

2.1. THE BENEFICIARY

(3) 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.

(4) Until 12 June 2017, the company was owned by the UK through Postal Services Holding Company Limited, which also held 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. Since 12 June 2017, POL is directly owned by the UK Secretary of State for Business, Energy and Industrial Strategy.

(5) In its financial year 2015/2016, POL's turnover (including compensation to provide SGEIs of £130 million, as approved by the Commission in Case SA. 38788 (2015/N)) amounted to £1,111 million. POL reported an operating profit before taxation of £105 million for the same financial year. At the end of POL’s financial year 2016/17 POL had 5,302 employees.

(6) POL’s nationwide network includes c. 11,600 post office branches (hereafter "Branches"). At the date of the notification, POL owned and managed directly c. 337 (only c. 3%) of these post offices (hereafter “Crown Branches”). The post offices of the remainder (c. 97%) of the network are owned and managed by independent businesses (hereafter "Third Party Operators"), who have entered into agreements with POL to manage a post office (hereafter "Agency Branches"). Many Third Party Operators operate an Agency Branch that is co-located alongside another retail business (e.g. selling stationery, food, newspapers and magazines).

(7) The business activities of POL (i.e. the services offered by both Crown and Agency Branches) are divided into five main categories for financial reporting purposes: (i) mails and retail services; (ii) financial and banking services; (iii) Government services; (iv) telecoms services; and (v) other income. 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.

(8) In its decision on case SA. 38788, the Commission made reference to POL's network transformation programme planned for the period 2015-2018 and other planned efficiency-enhancing initiatives including a reduction in POL’s central costs. The UK has confirmed that since 2015, POL has achieved significant progress with these initiatives. POL’s on-going programme of network transformation (ongoing since 2012) involves in particular the physical and operational modernisation of Branches and a re-design of the compensation structure for Third Party Operators. In terms of the impact of these initiatives on POL’s requirement for SGEI compensation, the total amount of SGEI compensation of POL could be reduced by 45% between the funding period 2012-2015 and the funding period 2015-2018 and will further reduce by 42% between the funding period 2015-2018 and the funding period 2018-2021 under the measure notified by the UK.

2.2. COMMISSION DECISIONS OF 28 MARCH 2012 AND 19 MARCH 2015

(9) 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 April 2012 to 31 March 2015 under its decision on case SA. 33054 (hereafter "2012 POL Decision").[2] On 19 March 2015, the European Commission approved SGEI funding arrangements (of £640 million, around €859 million[3]) for POL for the period 1 April 2015 to 31 March 2018 under its decision on case SA. 38788 (hereafter "2015 POL Decision").[4] In both decisions, the Commission found the measure to be in line with the 2012 EU Framework for State aid in the form of public service compensation[5] (hereafter "2012 SGEI Framework"), in particular because the aid did not exceed the net cost for providing the public service obligations entrusted to POL. These decisions also included the commitment by the UK to ensure future compliance of all POL's public contracts to provide SGEIs with EU public procurement rules.

2.3. THE PUBLIC SERVICE OBLIGATIONS ENTRUSTED TO POL

(10) For the funding period between 1 April 2018 and 31 March 2021 (hereafter "New Funding Period"), POL will be entrusted with the following public service obligations:

1. To maintain a Branch network above its optimum commercial size that is expected to and should, unless otherwise agreed, include at least 11,500 Branches, and which also meets the following access criteria ("Network SGEI"):

- Nationally: 99% of the UK population to be within three miles and 90% of the population to be within one mile of their nearest Branch;
- In urban areas: 99% of the total population in deprived urban areas across the UK to be within one mile of their nearest Branch;
- In urban areas: 95% of the total urban population across the UK to be within one mile of their nearest Branch;
- In rural areas: 95% of the total rural population across the UK to be within three miles of their nearest Branch; and
- POL is also required to ensure that 95% of the population of each and every individual postcode district is within six miles of their nearest Branch (establishing a minimum level of coverage at a very local level).

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

2 OJ 2012, C 121/01.

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

4 OJ 2015, C 188/01.

5 Communication from the Commission – European Union framework for State aid in the form of public service compensation (2011), OJ 2012, C 8/03.

2. To provide through the Branch network the below-listed services (together, "Product SGEI"). The Commission notes that POL has agreed to make best endeavours to provide Product SGEI under contracts that have been concluded on a fully commercial basis with a range of public and private bodies:

- 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; and
- Providing access to basic cash / banking facilities, especially for rural customers and those on social benefits.

(11) The Network SGEI concerns the provision of the Product SGEI in those parts of the overall Branch network which go beyond the network of an optimum commercial size.

(12) Two legal instruments entrust POL to deliver the SGEIs and outline the SGEI compensation measures for the New Funding Period.

(13) First, a legally binding letter to POL (hereafter "Entrustment Letter"), imposes obligations on POL to deliver the abovementioned SGEIs for the duration of the New Funding Period. The Entrustment Letter also imposes obligations on POL to prepare statements of account and to follow certain procedures for recovery of any over-compensation during the New Funding Period.

(14) Second, a funding agreement between the Secretary of State for Business, Energy and Industrial Strategy and POL (hereafter "Funding Agreement") contains a detailed and precise explanation of POL's obligations in relation to SGEI delivery. In particular, the Funding Agreement: (i) obliges POL to comply with precise requirements for delivery of the SGEIs; (ii) provides for payments of SGEI compensation over the three years from April 2018; (iii) obliges POL to use SGEI compensation only to meet SGEI costs incurred by it; and (iv) obliges POL to comply with certain procedures that prevent POL from retaining SGEI compensation in excess of the net cost of delivering the SGEIs during the New Funding Period.

2.4. THE NOTIFIED MEASURES

(15) In the current notification, the UK is seeking approval to provide partial funding for POL's provision of public services during the New Funding Period.

(16) The new Funding Agreement for POL 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 described above in recital (10).

(17) Subject to the receipt of Commission clearance, the UK has agreed to provide POL with annual SGEI compensation payments of up to £370 million (around €419 million[6]) in total, comprising: up to £*[...]** million in 2018/19; up to £*[...]* million in 2019/2020; and up to £*[...]* million in 2020/2021.

6 This conversion uses the ECB reference rate on 18 December 2017 of €1 = £ 0.88208.

**Confidential information*

(18) The SGEI compensation to be provided to POL for the New Funding Period will be less than the forecast SGEI net cost. Therefore, the notified measures provide for only partial compensation for POL's provision of the SGEIs. The remainder of the forecast SGEI net costs for the New Funding Period will be covered by the profit generated by POL's non-SGEI activities, including its offer of certain financial and telecoms services to the public.

(19) The proposed SGEI compensation is divided into two types: First, the SGEI compensation 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 New Funding Period (Network Subsidy Payment Funding, hereafter "NSP Funding"), up to £160 million over the New Funding Period. Second, the SGEI compensation is intended to compensate POL partially for exceptional investment costs (Network Investment Funding, hereafter "NI Funding"), up to £210 million over the New Funding Period.

(20) The SGEI compensation would be provided to POL across a declining trajectory, and is more than 40% below the POL funding of £640 million that was approved by the Commission in its 2015 POL Decision. According to the UK, the significant reduction of the compensation during the New Funding Period reflects cost savings POL could achieve by completing efficiency incentives during the last years.

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

(21) 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.

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

(23) 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, throughout a network of at least 11,500 offices (see above recital (10)). The assumptions underlying the forecasts and the forecasts themselves are included in the strategic plan and revolve around POL's planned commercial strategy and the related risks and opportunities.[7]

(24) In the counterfactual Scenario B, the alternative commercial strategy for POL (i.e. the optimal commercial strategy once the Network SGEI constraint is lifted) is determined.

(25) Once Scenario B has been constructed, the financial impact of the changes under Scenario B, i.e. the changes in POL's income and costs, is estimated. The net effect of these changes is the net cost of the SGEI based on the net avoided cost methodology.

[7] The core assumption in the strategic plan is that POL will continue its investments and efforts for a modernization of internal processes, products and services, which are crucial to POL's ability to grow income, reduce costs, compete, protect the network and deliver commercial sustainability.

2.5.1. Changes to the network in Scenario B

(26) The UK submits that in Scenario B POL would maintain an optimal commercial network of *[...]* post offices while still providing all its current services. The UK explains that this network size has been derived from a financial model that POL has developed with the help of external consultants. The financial model (named "Hydra") links financial data with POL Branches and determines which Branches are "commercial" and which Branches are "non-commercial". The UK submits that POL "non-commercial" Branches would be eliminated in Scenario B. In order to determine if a Branch is "commercial" or not, the model collects data related to Branch revenues, Branch direct costs as well as an appropriate portion of shared costs. The Branches that are profitable on that basis (i.e. revenues > direct + shared costs) are considered "commercial" and would therefore be kept in scenario B. According to the UK, this is the decision making process that POL would use to decide the appropriate network size in order to achieve the commercial objectives of POL in a scenario where it has no SGEI obligation. Based on this methodology *[...]* Branches would qualify as "non-commercial" thus not being part of the network under Scenario B.

(27) The optimal commercial network of *[...]* Branches thus accounts for c. *[...]*% of the size of POL's network today, showing that there is still a difference between the individual needs of POL in a fully commercial scenario on the one hand, and the public needs reflected by the SGEI requirements identified by the UK on the other hand.

(28) The Commission notes that the optimal commercial network under Scenario B is considerably bigger than the one under Scenario B in the 2012 and 2015 POL Decisions (*[...]* Branches versus *[...]* Branches before). According to the UK, this is mainly due to the increasing number of Branches that have been modernised via the network transformation initiative since 2012. The resulting efficiencies have made an increasing number of Branches profitable and therefore form part of a fully commercial network under Scenario B. Most importantly, since the network transformation started in 2012, an increasing number of Branches no longer receives fixed remuneration, resulting in a significant reduction of the Third Party Operators' transactions-related income paid by POL and increasing the profitability of these branches for POL.

(29) Together with other cost changes resulting from the modernisations, such as a reduction in Branch equipment costs, training and supporting staff costs, the number of Branches that are loss making on a variable cost basis has been reduced considerably. In addition, since 2012 the number of staff employed by POL has reduced from 7,798 to 5,302, resulting in POL's staff costs falling by £*[...]* million a year over the period to 2016/17. As much of this cost is allocated to Branches in the Hydra model, lower staff costs result in a lower allocation, and therefore a smaller number of Branches that are loss making on a variable cost basis.

2.5.2. Product SGEI changes in Scenario B

(30) No Product SGEI changes would occur in Scenarios B. POL would continue to provide all of the Product SGEI services that it currently provides as they could be conducted on a wholly commercial basis across this optimal commercial network of *[...]* Branches.

2.5.3. Income changes in Scenario B

(31) The income that POL is assumed to generate in Scenario B is based on a two-step analysis:

- First, POL estimates that the income of the *[...]* commercial Branches is fully retained (100%) in Scenario B.
- Second, the income generated by the non-commercial Branches is assumed to migrate to the remaining (commercial) network in line with estimated retention rates. The table below shows the expected income under Scenario A and B for the broad products/services categories of POL's business. The retention rates (% of the income of non-commercial Branches that POL would retain under Scenario B) are estimated based on previous POL experience from *[...]* branches closed in the 12 month period from September 2015 to September 2016. As these Branches were not replaced immediately by another Branch, POL has analysed the evolution of income at the three closest branches over the subsequent 12 month period to gauge the possible impact of the closure on income migration[8]. Where the rate of migration for a product implied by this analysis was greater than what had been earned at the closed Branch, migration was assumed to be capped at 100%. In Scenario B actual retention rates have only been applied to the top 15 products sold in the *[...]* sample Branches, and to be conservative no income was assumed to migrate from any other product[9]. The top 15 products account for *[...]*% of revenue in these branches, and are mostly high volume services.

<u>Table 1: Income Retention Rates</u>

Top 15 Products	% Income Retained in Nearby Branches	Income Category
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*

[8] As part of this work, POL stripped out network wide effects from nearby Branches, such as adjusting for growth in particular products experienced by the Branch network as a whole.

[9] These account for *[...]*% of revenue, and are typically lower volume services such as *[...]* more frequently sold via call centres online. Users of Branches are expected to find alternate provision for these services.

[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*
[…]	*[…]*	*[…]*

(32) Applying the described above methodology, the UK submits the following expected annual income for POL under Scenarios A and B for the New Funding Period, as shown in the following table.

Table 2: Expected annual income in Scenarios A and B in 2018-2021

	2018-2019					
	Scenario A			**Scenario B**		
GBP million	**Commercial Branches**	**Non-commercial Branches**	**total**	**Commercial Branches**	**Non-commercial Branches**	**total**
Mails and Lottery	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Government Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Telephony	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Financial Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

Fixed Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Branch Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Non-Branch Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Income			*[…]*			*[…]*

	2019-2020					
	Scenario A			**Scenario B**		
GBP million	**Commercial Branches**	**Non-commercial Branches**	**total**	**Commercial Branches**	**Non-commercial Branches**	**total**
Mails and Lottery	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Government Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Telephony	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Financial Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Fixed Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Branch Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Non-Branch Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Income			*[…]*			*[…]*

GBP million	2020-2021					
	Scenario A			**Scenario B**		
	Commercial Branches	**Non-commercial Branches**	**total**	**Commercial Branches**	**Non-commercial Branches**	**total**
Mails and Lottery	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Government Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Telephony	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Financial Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Fixed Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Branch Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Non-Branch Income	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Income			*[…]*			*[…]*

2.5.4. Cost changes in Scenario B

(33) POL divides the costs incurred in four categories: direct costs, shared costs, sustaining costs and other costs.

<u>*Direct costs*</u>

(34) Direct costs are 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 vary with a change in the volume of a specific output or number of Branches. In general, a portion of the direct costs is expected to 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 Branches to the post offices that make up the optimal commercial network.

(35) For estimating the direct costs of Scenario B POL assumes that the direct costs related to the commercial Branches are fully retained and the direct costs of the non-commercial Branches are migrating to the remaining network at the same rates

as the income (as described earlier see recital (31)). As a result, POL estimates that *[…]*% of the overall direct costs of the non-commercial Branches included in Scenario A would be retained in Scenario B, as shown in the following table.

Table 3: Expected direct costs in Scenarios A and B in 2018-2021

	2018-2019					
	Scenario A			Scenario B		
GBP million	Commercial Branches	Non-commercial Branches	total	Commercial Branches	Non-commercial Branches	total
Mails and Lottery	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Government Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Telephony	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Financial Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Outreach costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Pay to Third party operators	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total direct costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

	2019-2020					
	Scenario A			Scenario B		
GBP million	Commercial Branches	Non-commercial Branches	total	Commercial Branches	Non-commercial Branches	total
Mails and Lottery	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Government Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

Telephony	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Financial Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Outreach costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Pay to Third party operators	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total direct costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

	2020-2021					
	Scenario A			Scenario B		
GBP million	Commercial Branches	Non-commercial Branches	total	Commercial Branches	Non-commercial Branches	total
Mails and Lottery	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Government Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Telephony	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Financial Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Outreach costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Pay to Third party operators	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total direct costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

Shared costs

(36) These are costs incurred by POL in order to support the Branch network (e.g. variable IT system costs and cash supply and logistics costs). They vary with a change in the total volume of output, but they are not directly variable by Branch. For estimating the shared costs of Scenario B POL assumes that the shared costs related to the commercial Branches are fully retained. As regards the shared costs related to the non-commercial Branches, each category of POL's shared costs has been individually analysed and POL estimates that *[…]*% of the overall shared costs of the non-commercial Branches included in Scenario A would be retained in Scenario B, as shown in the following table.

Table 4: Expected shared costs in Scenarios A and B in 2018-2021

2018-2019/2019-2020/2020-2021*						
	Scenario A			Scenario B		
GBP million	Commercial Branches	Non-commercial Branches	total	Commercial Branches	Non-commercial Branches	total
Supply Chain	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
IT and Technology	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Corporate Services	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Other Branch Costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Shared Costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

*The amounts are the same every year of the funding period

Sustaining costs

(37) Sustaining costs do not generally vary with a change in the volume of output and include allocated overheads (e.g. fixed IT system costs product delivery and logistic costs, network management, administration and interests). For estimating the sustaining costs under Scenario B POL assumes that the costs of both commercial and non-commercial Branches are subject to a potential saving. Each individual component of POL’s existing sustaining cost base has been separately considered and POL estimates that *[…]*% of the overall sustaining costs included in Scenario A would be retained in Scenario B, as shown in the following table.

Table 5: Expected sustaining costs in Scenarios A and B in 2018-2021

	Scenario A			Scenario B		
GBP million	**2018-2019**	**2019-2020**	**2020-2021**	**2018-2019**	**2019-2020**	**2020-2021**
Product Delivery and Logistics Support	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Fixed IT System Costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Telephony Support - Helplines for Third Party Operators	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Head Office Network Monitoring and Management Support	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Head Office Personnel and Other Functions (i.e. Finance, Legal)	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Revolving Credit Facility Interest Costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Total Sustaining Costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

Other costs

(38) In addition to the three categories mentioned above, other costs are:

- Depreciation costs: These costs relate to the depreciation of the assets of POL.

- Exceptional investment costs: These costs are investment costs incurred by POL that cannot be capitalised, and as such they are treated by POL as an exceptional entry in its profit and loss statement. Some of these vary with a change in the volume of output or number of Branches (e.g. certain investments associated with Branch-based IT and equipment), while others do not (e.g. central IT infrastructure or investment on new products).

(39) To estimate depreciation costs in Scenario B, POL takes a diversified approach, taking into account different cost retention rates for different types of assets. Generally assuming that depreciation costs would be lower in Scenario B as a result of the reduction of the Branch network size, the depreciation costs of assets are retained proportionally. In some areas where capital expenditure in Scenario A is not related to the number of Branches in the network, no adjustment has been made to Scenario A forecasts (i.e. *[…]*% retention). In other areas POL would

expect to adopt a different strategy in Scenario B, resulting in capital expenditure being significantly lower than it is in Scenario A. In particular, in Scenario B POL assumes that it would not seek to implement *[...]*, but would instead *[...]* as a *[...]*, which would be more *[...]* and therefore also more efficient.

(40) Based on this methodology POL estimates that *[...]*% of the overall depreciation costs in Scenario A would be retained in Scenario B. This corresponds almost proportionately to the reduction of the size of POL's network.

(41) To estimate exceptional investment costs in Scenario B POL has adjusted estimates for Scenario A based on how it expects its business to invest in the counterfactual scenario. Where these costs are not related to the number of Branches in the network, no adjustment has been made in Scenario B (e.g. financial services and mails investments) resulting in these costs being fully retained. Where these costs are related to the number of Branches in the network Scenario A, the costs have been reduced, by the proportional reduction in the size of the network between Scenarios A and B (e.g. exceptional investments on Branch and IT equipment). However, since the majority of the exceptional investment costs incurred by POL in Scenario A relate to the provision of the Network SGEI and in particular to the network transformation programme enhancing the efficiency of the Network SGEI, POL would expect to adopt a different strategy in Scenario B, leading to overall significantly lower exceptional investment costs being in this scenario. This includes the exceptional investments linked to the *[...]* outlined above, and also those linked to a series of efficiency programmes identified by POL, some of which are linked to the delivery of the SGEIs and therefore assumed not to take place in Scenario B. However, some are considered to be independent of the SGEIs and would therefore still be carried out, albeit at a scale that reflects the reduced size of POL’s network and business.

(42) Based on the methodology explained above it has been estimated that *[...]*% of the overall exceptional investment costs of Scenario A to be retained in Scenario B.

Table 6: Expected other costs in Scenarios A and B in 2018-2021

GBP million	**Scenario A**			**Scenario B**		
	2018-2019	**2019-2020**	**2020-2021**	**2018-2019**	**2019-2020**	**2020-2021**
Depreciation costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*
Exceptional investment costs	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*	*[…]*

2.5.5. Conclusion on Scenario B

(43) Table 7 shows the overall result of the net avoided cost methodology, presenting the estimated income and costs of POL in a scenario A and B, i.e. with and without the Network SGEI obligation. The amounts of this table are drawn (sums) from Tables 2 to 5 above.

<u>Table 7: Net Avoided Cost</u>

		2018/19 (£ mil)	2019/20 (£ mil)	2020/21 (£ mil)	Total (£ mil)
Scenario A with the Network SGEI [11,500 offices]	Income:	*[…]*	*[…]*	*[…]*	*[…]*
	Costs	*[…]*	*[…]*	*[…]*	*[…]*
	Net income/(loss)	*[…]*	*[…]*	*[…]*	*[…]*
Scenario B without the Network SGEI [*[…]* offices]	Income	*[…]*	*[…]*	*[…]*	*[…]*
	Costs	*[…]*	*[…]*	*[…]*	*[…]*
	Net income/(loss)	*[…]*	*[…]*	*[…]*	*[…]*
Net Avoided Cost (C=B-A)		*[…]*	*[…]*	*[…]*	*[…]*
Compensation (D)					**370**
Undercompensation (E=C-D)					*[…]*

(44) Thus, the total SGEI net cost figure of £*[…]* million included in Table 7 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 mentioned above in recital (23). However, as explained in recital (17) 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

(45) 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"*.

(46) 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 resources.

ii. It has to confer an economic advantage on undertakings.

iii. The advantage has to be selective.

iv. The measure has to distort or threaten to distort competition and affect trade between Member States.

(47) 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.

(48) In addition, in its 2012 POL Decision (recitals 35-45) and its 2015 POL Decision (recitals 57-73), the Commission noted that the compensation granted to POL for discharging the public service obligations over the periods 2013-2015 and 2015-2018 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

(49) 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.

(50) 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.

(51) 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

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

(53) Article 107(1) TFEU requires that a measure, in order to be defined as State aid, favours "certain undertakings or the production of certain goods". The Commission notes that the SGEI compensation will be granted to POL only. Given that the present case concerns an individual aid measure, the identification of the economic advantage (see section 3.1.3) is sufficient to support the presumption that it is selective.[10] In any event, it does not appear that other undertakings in the same or other sectors in a comparable factual and legal situation benefit from the same advantage. Hence, the measure is selective within the meaning of Article 107(1) TFEU."

[10] See Cases C-15/14 P Commission v MOL, EU:C:2015:362, paragraph 60, C-270/15 P Belgium v Commission, EU:C:2016:489, paragraph 49, T-314/15 Greece v Commission, EU:T:2017:903, paragraph 79.

3.1.3. Economic advantage

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

(55) 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.

(56) In particular, the four cumulative 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").

(57) In its 2012 POL Decision and its 2015 POL Decision, the Commission concluded that this compensation was not *Altmark* compliant.[12] The UK authorities have not provided any new elements in the current notification demonstrating that the compensation for the delivery of the SGEIs by POL could respect 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 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.

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11 Laid down in Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH. See also points 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.

12 See 2012 POL Decision, C(2012) 1905 final, recitals 39-42, 2015 POL Decision, C(2015) 1759 final, recitals 65-68.

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

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

(59) 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.[13]

(60) The SGEI compensation granted to POL strengthens its economic situation and therefore threatens to distort competition and is 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.

(61) Accordingly, the notified measure affects trade between Member States and distorts or threatens to distort competition.

3.1.5. *Conclusion on the existence of aid*

(62) In light of the above, the Commission concludes that compensation to POL for costs incurred to provide the Network SGEI over the period 2018-2021 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

(63) 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. The Commission therefore concludes that the aid measure does not constitute unlawful aid.

3.3. COMPATIBILITY OF THE AID UNDER THE 2012 SGEI FRAMEWORK

(64) 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.

(65) The UK accepts that the proposed partial compensation of the forecast SGEI net cost should be analysed as State aid under the 2012 SGEI Framework as in the

[13] 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.

previous 2012 POL Decision and 2015 POL Decision. According to the 2012 SGEI Framework, the following compatibility criteria apply:

3.3.1. Entrustment and duration

(66) As required in points 15 and 16 of the 2012 SGEI Framework, an entrustment act which entrusts the provision of an SGEI to the undertaking concerned and spells out the nature of the task as well as the scope and the general operational conditions of the SGEI must be in place.

(67) The Entrustment Letter and the Funding Agreement specify POL's obligations in relation to SGEI delivery (see above recitals (12) to (14)). Specifically, the Entrustment Letter includes a set of precise requirements for the Network SGEI and the Product SGEI, and the Funding Agreement imposes an obligation on POL to deliver SGEIs meeting those requirements for the duration of the New Funding Period.

(68) The Entrustment Letter and the Funding Agreement also specify the methods of calculating the partial SGEI compensation. In particular, the "Method for Calculating Compensation" section of the Entrustment Letter specifies the calculation methodology to be used.

(69) The Entrustment Letter and the Funding Agreement also specify the procedure that applies for recovering any over-compensation. Specifically, the "Method for Calculating Compensation" and "Recovery of Overpayment" sections of the Entrustment Letter, as well as the Funding Agreement, place strict obligations on POL to prepare independently verified statements of the actual net SGEI cost incurred by POL and to return any SGEI compensation in excess of that amount to the UK on conclusion of the New Funding Period.

(70) On receipt of Commission's decision approving the notified measures, the obligations contained in the Entrustment Letter and the Funding Agreement will become legally binding on the parties.

(71) According to point 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.

(72) The Entrustment Letter entrusts POL for an additional period of three years (i.e. the New Funding Period) which is not to be considered excessive or disproportionate. The duration is aligned with POL's business planning period, and therefore it is the minimum timeframe for which the UK can estimate POL's future funding requirement with sufficient accuracy.

(73) 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.[14]

[14] Regarding the United Kingdom's intention to leave the Union pursuant to Article 50 of the Treaty on European Union and the application of this decision, please note the additional observation under recital (133).

3.3.2. *Genuine service of general economic interest and public consultation*

(74) As indicated in point 13 of 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.

(75) 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 of the other services 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.

(76) 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 and the 2015 POL Decision.

(77) 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, there is a public need for a local, accessible and secure serviced office environment. This practical 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 (e.g. due to the cost or health impact of travel and/or the availability of transport) and/or cannot easily access such services through alternative channels such as internet or telephone services.
- Second, there is a public need for local serviced offices to offer a bundle of key services, i.e. the possibility of completing multiple transactions in the same post office. This requirement arises in particular because retail areas are frequently widely dispersed and public transport links are irregular in many parts of the UK. For example, persons reliant on social security value the convenience and security benefits of being able to withdraw social security benefits and pay utility bills in a single local serviced office.

(78) In addition, the UK recognises a social policy requirement for the SGEIs, with post offices being a key part of the social fabric of communities. In particular, post offices foster social and territorial cohesion, and improve community life. These social effects of the public services are especially important where an increasing proportion of public communication is made through digital means, which cannot be accessed easily by certain parts of the population. Moreover, post offices act as a source of general information and advice on public services and this function is particularly important in rural and deprived urban areas, and for vulnerable groups.

(79) The above social policy effects of the SGEIs are especially important in an age 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.

(80) According to the information provided by the UK, the above-described public needs 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 sufficiently wide geographic coverage and might not be of a sufficiently high quality and offer a sufficiently wide range or bundle of Product SGEI to meet the public needs.

(81) 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.

(82) In addition, according to point 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.

(83) The public needs for the Network SGEI entrusted to POL, as required by point 14 of the 2012 SGEI Framework, have been confirmed by a public consultation and independent research commissioned by the UK pursuant to its commitment as referenced in recital 141 of the Commission's 2015 POL Decision.

(84) In November 2016 the UK published a comprehensive public consultation document seeking feedback from the public on the need for the SGEIs entrusted to POL (hereafter "Consultation"). In the Consultation the public was asked for their general views and for views on the following specific points:

- The appropriateness of the current criteria that are used by the UK to define the Network SGEI;
- The alternative approaches that could be used by the UK, instead of the current criteria, to define the Network SGEI;
- The availability of services, particularly for remote communities, vulnerable members of society and others that rely on over-the-counter transactions; and
- The ways in which communities might be able to play a wider role in the operation of the post office network.

(85) The UK received 31,083 responses to the Consultation, almost all (95%) of which were supportive of the UK's definition of the SGEIs, supporting the position set out in the Consultation.

(86) Moreover, in 2016 the UK published an independent econometric study that looked at the social value of the post office network ("Social Value Report"). This report built upon the methods used in a 2009 study by NERA which was referenced in the Commission's 2015 POL Decision, and was based on the results of a new survey of more than 5,000 individuals and small businesses. The key findings of this report include that: (i) the SGEIs provided across the post office network have an estimated social value of £9.3 billion per year; (ii) 95% of those surveyed purchase services available at their local post office at least once a year; and (iii) more than half (58%) of customers consider having all five of the SGEIs in one location to be important to them personally. These findings support that the public has a clear

need for the SGEIs and in particular for the bundle of services which POL makes available in one location.

(87) In addition to the above, the UK has presented additional recent reports, namely (i) the *Community Barometer of the Association of Convenience Stores* (August 2017), (ii) the C*itizens Advice Report on Consumer use of Post Offices* (July 2017), (iii) the C*itizens Advice Report on New-Style / Transformed POL Branches* (June 2017), (iv) the report *Tackling Financial Exclusion: A Country that Works for Everyone?* (March 2017). The results of these reports as further confirm the identified public need for the SGEI as entrusted to POL.

(88) 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[15]

(89) According to point 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."

(90) 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 Directive 2006/111/EC (hereinafter "Transparency Directive"). The granting of public funds to POL and their use 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, Energy & Industrial Strategy of the UK. 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 (a SGEI Statement and Cumulative SGEI Statement, as defined in the Funding Agreement) each year which will be verified by an independent financial advisor, which will ensure the necessary accounting separation and enable verification that there has been no over-compensation of POL's SGEI costs.

(91) 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 period specified in Article 6 of the Transparency Directive, as a minimum duration.

(92) For these reasons, the Commission considers that POL complies with the Transparency Directive.

3.3.4. EU Public Procurement Rules

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

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

(94) The Commission notes that 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. Nevertheless, in both its 2012 and 2015 POL Decisions[16] the Commission has accepted that, at the time, POL was the only operator whose network and contractual relationships actually satisfied 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 was followed to entrust POL with the Network SGEI, was justified under EU public procurement rules.

(95) As the UK has convincingly explained, in view of the New Funding Period POL continues to remain the only operator with the necessary characteristics to provide the Network SGEI. In particular, POL is the only provider:

- With the ability to meet the geographic access criteria of the Network SGEI. The dispersed nature of the UK population means that a commercially optimal network would be largely located in densely populated areas.

- With the ability to meet the quality and capacity needs of the UK and the expectations of the SGEI users.

- Capable of offering a bundle of different services like the Product SGEI through a single, cohesive network, and with certain quality characteristics.

- Performing a social and economic role for communities across the UK. Its Branches often work as focal points for local communities and are relied upon by many people, small businesses and vulnerable groups as sources of information and advice on public services.

(96) Based on the above elements, the Commission considers that POL remains in a unique position to provide the Network SGEI, and that, according to the elements provided by the UK there is no reasonable alternative or substitute to provide for the same public services. The Commission therefore concludes that the use of a negotiated procedure without prior publication based on Article 32(b)(ii) of Directive 2014/24/EU on public procurement to entrust the Network SGEI to POL is justified.

(97) The 2012 (in recital 15) and the 2015 (in recital 13) POL Decisions endorsed the UK commitment to ensure, in the future, the compliance with EU public procurement rules of all POL's public contracts to provide services which are part of the Product SGEI, in the light of the link between the delivery of the Product SGEI services and the Network SGEI.

(98) In this respect, the Commission notes that the UK in the past complied with the above commitment and renewed this commitment for the future. In that context, the UK provided a contract review covering all public Product SGEI contracts which

[16] See 2012 POL Decision, C(2012) 1905 final, recital 67, 2015 POL Decision, C(2015) 1759 final, recital 102.

are subject to the European public procurement Directives[17] because they (i) were concluded between POL and a contracting authority that is subject to public procurement rules and (ii) had an aggregate value in excess of the relevant EU threshold (the lowest threshold being £106,047). Since the 2015 POL Decision, *[…]*. Furthermore, *[…]* contracts have ended in the meantime.[18]

(99) The UK's Product SGEI review shows that these contracts were:

- either tendered by the relevant contracting authority in a manner compliant with EU public procurement rules,[19]

- or covered by the sole provider exemption and therefore the negotiated procedure without prior publication was justified under EU public procurement rules.[20]

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

3.3.5. Absence of discrimination

(101) 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".

(102) As the SGEIs 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

<u>Amount of compensation and the net avoided cost methodology</u>

(103) According to point 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."

[17] Directives 2014/23/EU, 2014/24/EU and 2014/25/EU, or their predecessors Directives 2004/17/EC and 2004/18/EC, if applicable *ratione temporis*.

[18] More specifically, (i) *[…]* and (ii) *[…]*. *[…]* contract was terminated following *[…]*, consistently with commitments provided by the UK authorities ahead of the 2015 POL Decision.

[19] 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) Online Identity Assurance Framework Agreement and Call-off contract with the Cabinet Office (v) Front Office Counter Services (FOCS) framework (vi) the Driver Licence and Motor Tax Applications Services for DVLA (vii) Passport check & send services for Her Majesty's Passport Office (the latter two were advertised as part of the procurement of the FOCS Framework).

[20] That is to say the Master Distribution Agreement with Royal Mail (consistent with Article 40(3)(c) of Directive 2004/17/EC and Article 50(c) of Directive 2014/25/EU).

(104) According to point 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."

(105) According to point 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."[21]

(106) 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 2.5 above, this methodology has been implemented in accordance with the requirements of the 2012 SGEI Framework by calculating: (i) the net income / loss of POL operating with an obligation to deliver the Network SGEI (Scenario A), (ii) the net income / loss 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).

(107) The calculations for Scenario A are based on POL's actual projections specified in its strategic plan.

(108) For the following reasons, the Commission considers that the measure complies with the net avoided cost methodology as described in points 21 to 25 of the 2012 SGEI Framework :

- The Commission notes that under Scenario B, an optimal commercial strategy is developed for each business activity (as described above in recital (7)), after considering which of its current business activities would be commercially rational for POL to continue in Scenario B.
- Based on knowledge of market conditions and POL's accounting system, a financial picture of Scenario B is constructed. As described in detail in section 2.5 above, the Commission notes that this financial picture has been calculated on the basis of POL's accounts and its relevant experience (e.g. closures of Branches in the past).
- The Commission concludes that all necessary measures are taken to avoid double-counting[22] in the overall financial picture for Scenario B. It is also a

[21] 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.

[22] 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.

positive point that the calculations have been verified by an independent financial adviser.

- From the Commission's assessment, the resulting financials including the annual profits in 2018/19, 2019/20 and 2020/21 of £*[...]* million, £*[...]* million and £*[...]* million respectively (meaning return on sales, of *[...]*% to *[...]*%) are realistic when benchmarked against publicly available financials for businesses that are similar to POL in Scenario B. In particular, the UK has undertaken a benchmarking analysis in relation to the net income / profit figures and return on sales for Scenario B in each year of the Funding Period and compared to a range of firms that are active in similar markets to POL or have other similarities to POL. Although the unique nature of POL's business, in particular in respect of the wide range of services that POL makes available through its network of Branches, means that there are no directly comparable undertakings to POL, it can be noted that the assumed profit level is in line with the profitability of a range of firms that are active in similar markets to POL or have other similarities to POL.

(109) 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 points 21-32 of the 2012 SGEI Framework.

Efficiency incentives

(110) According to points 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."

(111) As shown in Table 7 above, the proposed total amount of SGEI compensation for the New Funding Period is forecast to only provide POL with partial compensation for its total SGEI net cost. This partial compensation structure strongly incentivises POL to increase its efficiency. This is because, provided that POL is not over-compensated, POL is entitled to retain any efficiency gains that it can make in its delivery of the SGEIs (e.g. POL could retain a greater proportion of its profit from non-SGEI activities if its net SGEI costs were lower).

(112) Moreover, clause 2.1 in conjunction with Schedule 4 of the Funding Agreement sets out a series of annual "milestones" as a pre-condition to the agreement of the Secretary of State to release annual SGEI compensation payments to POL during the New Funding Period. These milestones relate to: (i) POL continuing to meet certain requirements in respect of the physical network's size, (ii) POL providing the UK with an annual strategic plan each year, setting out the steps that it will take inter alia in respect of the Strategic Plan for that year and (iii) POL providing the UK with relevant SGEI statements, prepared in a manner similar to those required under Case SA. 38788.

(113) In order to achieve the aforementioned milestones against the proposed amount and phased release of SGEI compensation, POL must increase the efficiency of its

operations. Efficiency increases are required not only in relation to the operation of POL's 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 set out in the strategic plan will be set out for each relevant year in each annual strategic plan. In the event that POL does not meet some of the targets set out in an annual strategic plan, it is required to include details of mitigating actions being taken in subsequent annual strategic plans. These requirements will be monitored by the UK.

(114) Based on the above, it can be considered that the notified measure contains sufficient efficiency incentives for the provision of the Network SGEI.

Separation of accounts

(115) According to point 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."

(116) 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.

(117) 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.

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

Absence of overcompensation

(119) As shown in Table 7 above, the proposed SGEI compensation for the New Funding Period (£370 million) are significantly less (by around *[...]*%) than POL's forecast SGEI net cost (£*[...]* million). Therefore, there is no prospect of any overcompensation of POL over the New Funding Period.

(120) In addition, to prevent any overcompensation arising in the New Funding Period, a calculation equivalent to that set out in Table 7 above will be carried out ex post each year comparing the actual SGEI net cost to the amount of permissible SGEI compensation.

(121) More particularly, in the Funding Agreement, the UK has provided for the following strict safeguards for the avoidance of overcompensation:

- Under clause 5.9 of the Funding Agreement, POL must provide the Secretary of State, within three months of signature of POL's accounts in respect of each financial year in the New Funding Period, a financial statement (hereafter "SGEI Statement") of (i) the SGEI net cost incurred in

POL's most recent financial year and (ii) the cumulative amount of SGEI net cost incurred by POL since 1 April 2018. The SGEI Statement must also include a clear explanation of how the aforementioned amounts have been calculated. Each SGEI Statement will be accompanied by a statement from an independent firm of financial advisers confirming that the statement has been prepared in accordance with the requirements of the Funding Agreement, and that they have not become aware of any inconsistency in the use of SGEI compensation payments as compared to the terms of the Funding Agreement or any State aid requirements. The SGEI Statement may also be further verified by an accountancy firm appointed by the UK where this has been requested by the Secretary of State.

- Under clause 5.10 of the Funding Agreement, 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 within 10 business days of a request from the Secretary of State.
- Under clause 5.11 of the Funding Agreement, POL may only use public funding to meet costs associated with its provision of the SGEIs; and
- The UK 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 over-compensation.

(122) 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.

(123) 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

(124) Points 51 et seq. of the 2012 SGEI Framework, and in particular point 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.

(125) 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.

(126) In relation to the limited non-compete restraint included in the contract between POL and Third Party Operators as mentioned in recital 135 of the 2015 POL Decision, the UK have referred to and repeated its submissions made in the procedure of the 2015 POL Decision on why the non-compete restraint 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 and to compete on a level playing field with its competitors. Based on the Commission's detailed assessment in recitals 131 to 139 of its 2015 POL Decision, the non-compete restraint therefore continues to be justified, proportionate and does not unduly distort competition in a way that is contrary to the interests of the European Union.

(127) In addition, the Commission notes that the potential risk of distortion of competition is further mitigated by the network access commitment to allow for competitor access to POL's network where certain conditions are met, as referred to in recital 137 of the 2015 POL Decision. The UK has explained that POL complies with the network access commitment and is satisfied with the transparent, consistent, efficient and appropriate procedures that POL has implemented to deal with access requests. Finally, the UK has renewed the network access commitment for the duration of the New Funding Period.

(128) 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

(129) Point 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;

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.

(130) The UK has confirmed that these transparency requirements have been complied with during the current funding period and will be complied with during the New Funding Period. In particular, the UK has confirmed that it will ensure compliance by making publicly available the following information regarding the proposed measures:

- The results of all public consultations on the public need for the SGEIs;
- The content and the duration of the entrusted SGEIs;
- The undertaking and territory concerned with the provision of the entrusted SGEI; and
- The amounts of SGEI compensation to be granted to POL on an annual basis.

(131) Furthermore, the UK has confirmed that it will report to the Commission on the compliance of all SGEI entrustments that fall within the Framework at two-year intervals, in order to provide an overview of the application of the Framework to the different sectors of relevant SGEI providers in the UK, in accordance with the requirements under point 62 of the SGEI Framework.

3.3.9. Conclusion on the compatibility with the internal market

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

3.3.10. Additional observations

(133) Since the United Kingdom notified on 29 March 2017 its intention to leave the Union, pursuant to Article 50 of the Treaty on European Union, the Treaties will cease to apply to the United Kingdom from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification, unless the European Council, in agreement with the United Kingdom, decides to extend that period. As a consequence, and without prejudice to any provision of the withdrawal agreement, this decision only applies until the United Kingdom ceases to be a Member State.

4. DECISION

(134) 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 compensation granted to Post Office Ltd for the delivery of the public services over the period 2018-2021 constitutes 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 electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission