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S O L I C I T O R S

GUIDE TO THE
MOD CLAWBACK CLAUSE

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1. INTRODUCTION AND PURPOSE

This guide including the model clause is issued for the following reasons:-

- to achieve due compliance with the current Land Registration requirements;
- the need to bring about consistent approach in all MoD disposals;
- to enhance offers through transparency and visibility of the MoD standard disposal terms;
- to end argument and renegotiation following a sale 'subject to contract';
- to protect against defective clauses arising following proposals for redrafting of the clause;
- to ensure the clause is as litigation proof as possible.

The purpose of this guide is to provide a general outline of the principles that underpin the clawback and overage clauses to interested third parties. References in this guide to the clause are intended to refer to the full version of the clause unless otherwise stated. The guide is **not** intended to amount to a definitive explanation of how the clause works. Parties are urged to seek independent legal advice as to the meaning and effect of the clause.

2. DEFINITIONS

Although there are two versions of the clause (a full version and the short version) this guide is principally concerned with the full version of the clause, which combines two types of deferred payment (future consideration):

“Planning Clawback” – a payment arising from the enhancement in the value of the property which is triggered (usually) by the grant of planning permission. In short, the enhancement value represents the difference in value between the Market Value of part of the property subject to the planning permission, and a Base Value ascribed to that part of the property. The Clawback payment is a percentage share of such difference in value.

“Overage” – this payment is separate and distinct from clawback. It usually arises from the development of a unit in accordance with a planning permission granted in respect of the property. Overage represents a percentage share in the revenue generated from sales of units built on the property and/or the sale of an interest when they exceed a threshold level.

3. PURPOSE

Overage, is essentially positive, and is intended to encourage development of the sale land by the buyer. It results in a percentage share, of the revenue generated by the buyer when he disposes of units erected in pursuance of planning permission, becoming payable to the MoD.

Clawback is more defensive in nature and grows out of the history of the NAO requirements that land should not be sold at an under value. Therefore, the clause protects against land gaining extra planning permissions than those envisaged at the time of disposal of the land. The clause can still be used in a positive way enabling the buyer to be encouraged to invest in gaining in enhanced planning permissions. In certain circumstances the clause may be used for purely defensive purposes where it is less certain that there might be a later planning gain. In those particular cases the shortened version of the clause might be utilised; but his version should be regarded as the exception rather than the rule (and as to which further reference is made at the end of section 6).

4. PROCEDURE FOR USE

The Form of Offer to be completed by all bidders/offerors is formulaic in nature and therefore adaptable within boundaries. Other than the insertion of numbers and details as expressly provided for in the Form of Offer, the MoD will dispose of land pursuant to the terms of the clawback and overage clause with the details inserted from the Form of Offer.

The MoD discourages interested parties from seeking to negotiate changes in the terms of the clawback and overage clause and will usually prefer offers that contain no changes to the clause. Further, the MoD will only consider changes to the same in exceptional cases.

The procedure for use is as follows:-

A) PRE-SALES PACK PREPARATION

- (i) In conjunction with the selling agents, the areas of land to be disposed of will be marked out according to planning use (taking into account any planning brief that may be in existence through MoD's liaison with the relevant Local Authority). These areas will be separately identified, e.g. Area A may be commercial, and Area B may be residential.
- (ii) One clause per area will be applied. All blanks in the clause will be completed by the MoD's solicitors. This will depend upon the terms of the offer made by the buyer in accordance with the standard Form of Offer document appended to the clause.
- (iii) The clause will form part of the sales pack submitted to any party interested in tendering for the land to be disposed of and must be responded to by any interested party by reference to the completion of the Form of Offer.

B) SALE

In all but the most minor MoD land disposals (where the shortened version of the planning clawback clause might be utilised (see Section 6), the clause will be included in the sales pack to ensure that offers are made in full knowledge of the clause.

The attention of bidders/offerors is drawn specifically to the Form of Offer appended to the contract. They should note that any offer not complying with the Form of Tender will be rejected by the MoD.

Since the bidders/offerors will be aware of the clause before they make any offer, this should enable them to make their maximum offers based upon a proper commercial evaluation of the site, and the nature and effect of the clause.

C) BID EVALUATION

Offers can be assessed by a comparison with the examples of the operation of the clause set out below. Further, offers can be assessed by inserting variables into a spreadsheet similar to the example provided and making comparisons accordingly.

5. MONITORING AND COLLECTION OF CLAWBACK AND OVERAGE PAYMENTS

The MoD will appoint land agents for the term of the clause for the purpose of monitoring clawback payments and annual returns of overage payable. However, this does not relieve the buyer at any stage from fulfilling its contractual obligations (contained in the clause) to notify the MoD of a trigger event for the purpose of clawback, and more significantly to make clawback and overage payments when they fall due.

The MoD's land agent will review the overage calculations and ensure payments are agreed and paid on an annual basis by the buyer.

6. PLANNING CLAWBACK

The Planning Clawback provisions are to be found in Part 1 of the Schedule (in the full version of the clause). In the short version of the clause the majority of these provisions are replicated; but the short version of the clause utilises an equitable charge rather than a legal charge and the restriction is usually less onerous (as to which see the end of this Section 6)

What is planning clawback?

The essence of the covenant to be given by the buyer is to pay to the MoD a percentage of the difference in value between the Market Value of the relevant land subject to the grant of a planning permission, and the relevant land's appropriate Base Value.

- The Market Value assumes, amongst other matters, that it is subject to an at arm's length transaction.
- Base Value is initially equal to the purchase price paid for the land and is then made subject to a simple form of annual indexation (based on increases published by the Land Registry). However, the Base Value is also liable to change each time there is the grant of a further planning permission.
- The percentage of clawback payable is dependent upon the amount offered in the Form of Offer submitted by the successful buyer.

By whom is planning clawback payable?

In both versions of the clause Planning clawback is payable by the Buyer, together with his successors in title. The Buyer will be contractually bound to ensure that his successors in title enter into a direct covenant with the MoD in respect of future liability to pay planning clawback. A distinction arises between the full and shortened versions of the clause where in the full version, despite the sale of the property (or part) by the Buyer, the Buyer remains liable for future clawback payments flowing from the whole of the property. However, in the shortened version the Buyer may (subject to the novation of the covenant to the disponee) be released from the clawback liability.

When is planning clawback payable?

In both versions of the clause Planning clawback is due and payable on the date a Trigger Event occurs. The liability of the Buyer (and his successors) to pay planning clawback arises upon the execution of the clause and ceases at the end of the Clawback Period.

- A Trigger Event is the date of the grant of a planning permission, or the end of any period of appeal/challenge in respect of the same. However, the definition is extended to include the grant of certificates by the local authority under sections 191 and 192 of the Town and Country Planning Act 1990. It should be noted that different terms are provided for the payment of clawback if planning permission or section 191/192 certificates are granted to a person other than the Buyer.

- The Clawback Period is dependent upon the Termination Date offered in the Form of Offer submitted by the successful buyer, and may be extended in the event of a planning application which is still to be finally determined.
- It should be noted that various transactions are treated in the full version of the clause as 'Exempt Dispositions' for the purpose of the Buyer's liability to pay planning clawback. One Exempted Disposition is the disposal to the owner of a dwelling house with a curtilage and garage not exceeding 0.1 hectares. This also results in the release of the obligation to pay clawback in respect of the property the subject of the exempt disposition.

When is the shortened version of the planning clawback used?

The shortened version of the clawback should be used only in very particular circumstances and it is not intended to be used generally. For example, in the sale of a house with a large garden or adjoining paddock, it might be used where there is no expectation of development and potentially the land available for such development is quite limited. The shortened version of clawback is intended as a very basic measure to ensure that land is not sold at an under value in the unlikely event that there might be a later planning gain. For this reason, the shortened version of the clawback utilises an equitable charge rather than a legal charge. In addition, the form of restriction is based on the Land Registry Form L, for the reason that departments may not wish to be concerned with the formalities arising on each and every disposal. Consequently, it is simply left to a conveyancer to certify that the formalities have been complied with. Form L approaches the formalities on a "de minimis" basis therefore.

If for any reason greater control over disposals is required by the selling department then the consent procedure may be altered to utilise the form of restriction based on the Land Registry Form N instead. In that event the shortened version will require further modification in order to provide covenants on the part of the selling department similar to those that are contained in the full version of clawback.

7. OVERAGE

The Overage provisions are to be found in Part 2 of the Schedule (they are not relevant to the shortened version of the clause).

What is overage?

The definition of overage is truly formulaic in nature. Overage is calculated by reference to the difference between the aggregate of Revenue from Sales generated by the Buyer during the Overage Period, less the threshold amount. This figure is then multiplied by the Overage Percentage to give the Overage.

- Revenue from Sales means the amount (VAT exclusive) in respect of each building built substantially in accordance with the planning permission. It is also drafted to secure any remuneration or other benefit derived from the grant of a lease of a building. However, insofar as the disposal of a Unit is not pursuant to an at arm's length transaction, the true Market Value for the Unit will be substituted into the Overage calculation. It should also be noted that a contractual undertaking is also given by the Buyer not to enter into such transactions (subject to certain exceptions).
- The Overage Period means the Termination Date referred to under the clawback provisions.
- The threshold amount means the amount offered by the Buyer in its Form of Offer.
- The Overage Percentage is the amount offered by the Buyer in its Form of Offer.

By whom is Overage payable?

Overage is payable by the Buyer, together with his successors in title. The Buyer will be contractually bound to ensure that his successors in title enter into a direct covenant with the MoD in respect of future liability to pay overage. Further, despite the sale of the property (or part) by the Buyer, he is still liable for future overage payments flowing from the whole of the property.

When is Overage payable?

The liability to pay Overage arises upon the disposal of the constructed Units (which includes, amongst other matters freehold sale and leases) during the Overage Period. The payment of Overage is made twenty working days after the expiry of each Relevant Period.

- The Relevant Period means any period of twelve months during which any Unit remains to be constructed/completed/disposed of during the Overage Period. The Relevant Period commences upon the completion of the sale of the first Unit.
- At the end of each Relevant Period there is machinery providing for the supply of a statement by the Buyer to the MoD giving details of disposals made during that period, and MoD's right to obtain copy documentation upon which the statement is based.
- However, it should be noted that when the Buyer has made an Overage Payment in respect of a Unit, such Unit is thereafter released from any further Overage Payment.
- Lastly, in the event that there is a disposal of an interest (for example the sale of a right of way) in the Property by the Buyer, which neither amounts to an Exempt Disposition or a disposal of a Unit or intended Unit, which is consequently defined as a 'Turnover Disposition', the value of the consideration received shall be treated as a sum received on account of Revenue from Sales.
- The provisions relating to Exempted Dispositions still apply.

8. GENERAL PROVISIONS RELATING TO THE CLAUSE (FULL VERSION)

(It should be noted that the paragraphs (a) (b) (c) (g) and (h) below are also applicable in the short version of the clause although with reference to paragraph (c) the Buyer has the potential to novate the covenant on sale to a donee and be released from the clawback liability in the short version of the clause)

- (a) The clause provides the necessary machinery for dispute resolution insofar as a dispute arises in respect of the determination of any sum or monetary obligation due from party to another. The party appointed to determine such dispute acts as an Expert (Chartered Surveyor) and not an arbitrator pursuant to the Arbitration Act 1996.
- (b) Any sum due under the clause which is not paid within two months of the same having fallen due attracts interest at a rate of 4% above the base rate from time to time of the Bank of England.

- (c) As referred to above, if the Buyer disposes of any part of the Property (save for an exempt disposition), the Buyer promises to procure that the new buyer will enter into a Deed with the MoD in a form substantially to the like effect of the clause. However, the Buyer remains potentially liable for clawback and overage in respect of the whole of the property.
- (d) The Buyer is obligated to execute a Clawback Legal Charge over the property. This charge secures the repayment of all clawback and overage sums and continues to apply for the whole of the Clawback Period. Further, it also records that the parties apply for the entry in the Land Register of a restriction in favour of the MoD against the Buyer's title in respect of the property. This has the effect of preventing the Buyer from disposing of the property without the consent in writing of the MoD.
- (e) The MoD provides the following covenants:
- to release the property which is the subject of an exempted disposition together with the obligation to pay clawback in respect of the same, and when requested to do so, to provide a written consent pursuant to the restriction in the Clawback Legal Charge;
 - not to withhold consent to the registration of a disposition of the Property if the disponee has entered into a deed of covenant in substantially the same terms as the clause and supplied the same to the MoD: and when requested to do so, to provide a written consent pursuant to the restriction in the Clawback Legal Charge to such a disposition;
 - the MoD may consent (such consent not to be unreasonably withheld) to the postponement of the Clawback Legal Charge to a first legal charge to secure such sum as will enable the Buyer to complete the purchase of the property and/or to develop undeveloped land (subject to certain requirements of the first chargee). The form of document will usually be provided by the buyers lender;
 - the MoD will consent (subject to an indemnity from the Buyer) to join in agreements for the provisions of conduit services and roads.
- (f) The Buyer covenants with the MoD at all times during the Clawback Period, to comply with the provisions of the Town and Country Planning Act 1990 whether affecting the use of the property or otherwise, and to obtain all necessary licences and consent for the carrying out of operations on and the development of the property.
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- (g) The clause only produces sums payable to the MoD and the liability to pay clawback arises upon each Trigger Event during the Clawback Period.
- (h) The Buyer is subject to various obligations to the MoD in relation to the procurement of a Clawback Legal Charge which is enforceable against the Buyer and its liquidators, and its valid registration at Companies House.

9. EXAMPLES OF THE CLAUSE IN OPERATION (FULL VERSION)

The clause has been designed to be formulaic in nature allowing maximum flexibility on the part of the offeror to tailor his bid in such a way as to offer maximum consideration but taking into account his special needs and requirements. Set out below are some examples to demonstrate how developers in different situations may use the clause to maximise their bid but provide for payments to be made at different stages of the development.

Example No. 1

Scenario: a purchaser is offering for a large site where the development is likely to take place over a number of years. Funding is to be significant with high gearing.

Use of the clause – in this case the developer may feel that triggering payments of planning clawback on the grant of planning permission is a step too far in that having raised the money for the purchase, further money would be needed to be raised to pay the planning clawback. In this case the developer may feel that it is more appropriate to reduce the amount of planning clawback, say by 10% from the market expectation, but to enhance the overage payment so that a larger amount of the proceeds of sale are given by way of consideration once units are sold. In this way the developer is paying from revenues raised rather than from debt. It may be that in this scenario the developer feels that he is also able to compensate for the reduction in planning clawback by reducing the overage threshold. In this way overage would become payable sooner in the development of the site. This type of scenario can be considered more as a joint venture

type of approach – that is that both MOD and the developer share in the success of the actual development.

Example No. 2

Scenario: in this case a large site is being sold to a purchaser who does not require significant funding. The developer may be more interested in acquiring the site for addition to a land bank and expects that the planning process will be protracted.

Use of the clause - in this case it may be that by the time the clawback period expires the site is still yet to be developed. In this case the developer in making the offer attractive will skew the bid to provide for more planning clawback relatively. Furthermore due to the expected time span for the development of the site the developer may enhance the offer by providing for a longer clawback period than normal.

Example No. 3

Scenario: in this case a small site is being sold where the amount of development potential is limited. The purchaser is a private individual but intends to use the land for his own purposes and if there is any development potential, it is likely to be limited to modest in-fill.

Use of the clause – in this case development is unlikely and therefore any offer in relation to overage is probably inappropriate. Furthermore, the operation of the overage clause provides for annual returns of revenue from sales which fits uncomfortably with a small site where development is unlikely. However, value can be added to the offer by offering clawback so that in the case where planning permission is obtained for a small level of infill then this enhanced value is shared by way of planning clawback.

10. ANSWERS TO COMMON QUESTIONS ABOUT THE CLAUSE (FULL VERSION)

The following questions were raised by interested parties during the MoD's recent introduction of the clause. The MoD seeks to answer them at this point to assist interested parties in their use of the clause.

- **Q: Why does the definition of Base Value make allowance for the increase in land values prior to the trigger event?**

- A: In response to the demand that the Base Value should make allowance for land price inflation, a simple form of indexation has been provided based on annual increases published by the Land Registry (with reference to the House Price Index reports for the month in which the Property was transferred and by reference to the Region in which the Property is situated). The earlier practice in the past of valuing the land immediately prior to the grant of planning permission led to difficulties in the valuation because it was argued that such a valuation should include the hope value attributable to the land as a consequence of the planning discussions and work done with the planning authorities. This was not the intention of the original clause however and it has previously led to disagreements over Base Value where the payment of clawback tended to be delayed as a consequence. This procedure has now been abandoned in the later editions of the clause and in its current form the clause should encourage expediency in the payment of planning clawback whilst offering a degree of protection to the developer in the event of land price inflation.

- **Q: Why do the clawback provisions make no allowance for the increase in land values due to improvements carried out to the same or the costs of complying planning obligations in achieving a trigger?**

- A: These are factors that should be taken into account by the developer in respect of the offer he makes in relation to clawback. The ultimate level of these costs is wholly within the control of the developer. Once again the clause allows for flexibility in that the purchaser can offer a different amount of clawback based upon his estimate of the cost of complying with planning obligations. Historically, the clawback clause used to allow the costs of such compliance to be offset against the amount of clawback to be paid up to a maximum figure. In practice, negotiations became protracted and the payment of clawback would be delayed as some developers tried to maximise the amount of costs offset against clawback. With the clause it is now for the developer to make estimates before entering into contract and to factor those in to the amount of clawback offered.

- **Q: Why is there no allowance in the Overage provisions for the developer's costs and profits?**
 - A: These are factors that should be taken into account by the developer in respect of the offer he makes in relation to Overage. The ultimate level of these costs is wholly within the developers own control. The threshold part of the Overage calculation should be adjusted in the offer to take account of costs that the developer foresees in developing the site. Clearly the higher the costs of developing the site, then the higher the threshold will be, always bearing in mind that in a competitive situation the developers will be pitching their threshold to maximise the appeal of their offer.

 - **Q: Is a prospective buyer able to offer only clawback or only overage?**
 - A: Yes, however the Form of Offer has to be used by the bidder/offeror. In addition, the provision has been made in the Form of Offer for the offeror/bidder to offer revised terms of the clause in an exceptional case. The Form of Offer also provides for an alternative offer without Clawback and Overage. Once again it should be understood that an offer which includes variations to the clause will not be a preferred offer.

 - **Q: If the Buyer sells the property on, and the new buyer enters into a direct covenant along the lines of the clause, does the original buyer still remain liable to pay clawback/overage in respect of the whole of the property?**
 - A: Yes. The MoD has no control over the strength of the covenant provided by the new buyer.

 - **Q: In what circumstances will the MoD consent to the postponement of their Clawback Legal Charge to a lender's first legal charge?**
 - A: Ultimately this will depend upon the facts of each case. However, in no circumstances will the MoD consider postponing their Clawback Legal Charge to a first legal charge which secures borrowing exceeding the value of the property. It should also be remembered that the postponement is allowed only for the purchase and/or development of the site and not to allow the site to be used as general security.

 - **Q: Is a prospective buyer able to vary the terms of the clawback and overage once an offer has been made and accepted subject to contract?**
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- A: No. It should be made clear that if the selected purchaser insists on this then the property will need to be remarketed as any such post-tender variation could be seen as unfair on losing bidders. To help prospective buyers they can exceptionally offer revised terms from the outset, i.e. at the bidding stage, but should give a full explanation and justification to assist the bid evaluation. To that end, the Form of Offer is worded to provide for this option.

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