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Broadband Delivery UK

2016 National Broadband Scheme for the UK

Guidance: Clawback

1. What is clawback?

1.1. Clawback refers to the repayment of any *excess* subsidy that may have been granted to a beneficiary of State aid.

1.2. In the case of the roll out of a subsidised broadband project, it refers to the possibility that an implementing body may have to recover any *excess* subsidy that the successful supplier concerned has benefited from.

2. Why is it needed?

2.1. It is a requirement of the European Commission's Broadband Guidelines that the successful supplier is not overcompensated. Overcompensation could arise, for example, if demand for the wholesale broadband services is materially greater than originally expected, so that the level of public subsidy received by the supplier is shown to be higher than necessary.

2.2. While a supplier may benefit from aid provided when State aid clearance is obtained (in this case, from BDUK as National Competence Centre), that aid must be the minimum necessary to deliver the objective of the aid (i.e. broadband roll-out in an area where the market has not delivered and will not deliver). The minimum level necessary is based on a number of factors which are subject to change. It is possible that change in those factors (e.g. higher take-up than originally anticipated) could mean the supplier has benefited from excess aid.

2.3. To guard against this risk, the Broadband Guidelines require that a clawback mechanism is included in the contract with the successful supplier. Through this mechanism, it is possible to retrospectively adjust the amount of aid from which the supplier has benefited.

2.4. However, BDUK and the European Commission accept that this may not be appropriate in cases where the broadband project is low value (below £150,000). In such cases the inclusion of a clawback mechanism may represent a disproportionate administrative burden. The 2016 NBS does not require a clawback mechanism in these limited circumstances.

3. How should the clawback be repaid? Can it be re-invested in the broadband network?

3.1. In a gap-funding model, the clawback mechanism should require the supplier to repay the forecast clawback amount to the implementing body: (i) as soon as it becomes due, based on the calculation of claw-back in the contract based on actual take-up levels achieved at that point; and (ii) as soon as the forecast take-up levels trigger the supplier to recognise it as contingent liability in its financial accounts.

3.2. In other models where this approach is inappropriate (such as some public ownership models), the clawback mechanism will instead require the supplier to repay the clawback amount to the implementing body at the end of the contract.

3.3. It is for the implementing body to decide how to use any repaid clawback. The contract with the supplier must not include any conditions as to its use (such as requiring its re-investment with the supplier).

3.4. If the implementing body decides to invest the clawback in further broadband deployment, it is only possible to re-invest this in the existing contract in compliance with EU public procurement rules. The additional public funding (including clawback) must generally be below 10% of the initial contract value.[1]

4. What is the structure of the clawback mechanism in the 2016 NBS for gap-funding?

4.1. For the gap-funding model, the clawback mechanism required by the 2016 NBS is based on the two main factors likely to drive greater than forecast profits for suppliers and therefore likely to contribute to excess subsidy (which needs to be clawed back). These are:

- Higher actual take-up of broadband products than forecast; and
- Higher actual revenues from 'non-broadband' products than forecast.

4.2. This clawback mechanism uses these factors as proxy for profitability. It then calculates the excess subsidy received by the supplier by allocating these profits between the parties in proportion to their relative contribution to the build costs.

[1] *European Commission, SA. 40720 (2016/N) – National Broadband Scheme for the UK for 2016-2020, paragraphs 89 and 90* http://ec.europa.eu/competition/state_aid/cases/263954/263954_1760328_135_4.pdf

4.3. BDUK's template contract calculates the clawback from these two factors in the following way:

- **Take-up:** actual take-up of broadband products on the network will be compared to the forecast take-up at agreed points in time set out in the contract between the local body and the supplier. The net surplus/deficit of take-up during each relevant period will be multiplied by a proxy figure for the net margin (as specified in the contract[2]). The aggregate of this calculation over all previous periods up to that point shall be treated as excess subsidy. Assessment of take-up (actual v forecast) will take place on each anniversary of the date of contract signature up to and including the end of the contract.

- **Non-broadband products:** actual revenues for non-broadband products sold on the network will be compared to the forecast revenues for non-broadband products during each relevant period and multiplied by a proxy figure for the net margin (as specified in the contract).[3] The aggregate of this calculation over all previous periods up to that point shall be treated as excess subsidy. Again, assessment of revenues (actual v forecast) will take place on each anniversary of the date of contract signature up to and including the end of the contract.

4.4. By applying an investment ratio related adjustment to the clawback calculation with respect to net margin, the clawback will accrue slower where the supplier has invested a higher proportion in relation to the public subsidy. The purpose of this approach is to incentivise suppliers to use lower levels of public subsidy, and to strive for additional take-up throughout the contract life.

4.5. The excess subsidy to be returned will not exceed the subsidy to the supplier.

5. How long must the clawback mechanism be in place?

5.1. The clawback mechanism must be in place for at least the duration of the contract between the implementing body and the supplier, which would mean for a minimum of at least 7 years post-completion of the deployment.

6. How do I demonstrate compliance with requirements of the 2016 NBS?

6.1. Implementing bodies must provide a copy of the invitation to tender and draft contract to BDUK before a procurement is launched.

6.2. BDUK's National Competence Centre will then assess whether the clawback mechanism is compliant with the requirements of the 2016 NBS. Where the implementing body has

[2] Refer to paragraph 9 of Schedule 5.1 of the Template Contract for detail.
[3] Refer to paragraph 10 of Schedule 5.1 of the Template Contract for detail.

adopted the clawback mechanism set out in BDUK's template documents, there are unlikely to be any issues.

7. What reporting is required on the clawback?

7.1. As part of receiving State aid approval from the NCC, implementing bodies will be required to regularly report on the operation of the clawback mechanism. These reporting and monitoring requirements will therefore also need to be incorporated in the implementing body's contract with the supplier. This is reflected in the template set of reports (set out in Schedule 6.4 to the Template Contract).

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