

CONSULTATION ON THE MODIFICATION OF STANDARD LICENCE CONDITIONS FOR A NEW ELECTRICITY DISTRIBUTION LICENCE HOLDER PURSUANT TO SECTION 8A OF THE ELECTRICITY ACT 1989

Dear Sir/Madam

24 September 2003

REGULATION OF A NEW ELECTRICITY DISTRIBUTION LICENCE HOLDER

Introduction

On 31 May 2002 Ofgem published an open letter requesting views on the regulation of any new electricity distribution licence holders. The letter of 31 May dealt with matters relating to charging, quality of service, financial ring-fencing and regulatory accounts for any new electricity distribution licence holders. It made proposals for interim arrangements to ensure that the interests of consumers are properly protected and said that these could remain in place until a wider ranging review of these matters can be completed. It is the present intention to publish a consultation paper on the wider review later in 2003.

This letter summarises the views of respondents to the 31 May letter and initiates a statutory consultation process on the standard licence conditions for a new electricity distribution licence holder pursuant to section 8A of the Electricity Act 1989 (as amended).

Energy Networks Limited (ENL) has applied for an electricity distribution licence. It is appropriate to propose modifications to the standard licence conditions (SLCs) of the licence that ENL has applied for so that if the licence is granted then the conditions will be sufficiently robust to protect the interests of consumers. The proposed licence condition BA1 is designed to introduce formal price control conditions that would create similar obligations as those applying to existing licensees. All other proposed conditions are intended to reduce the risks of financial failure by providing obligations similar to those on existing licensees. Therefore, these changes will not apply to existing electricity distribution licences as these licences already contain conditions relating to charging, quality of service, financial ring-fencing and regulatory accounts that have been designed to protect the interests of consumers in their distribution service areas. To the extent that distribution licensees compete with each other in the provision of services such as connections then the proposed modifications are such that that ENL should not be unduly disadvantaged in competing with other holders of an electricity distribution licence and vice versa.

Charging Arrangements

The 31 May letter explained that at present the SLCs do not contain any formal price control obligations and provide only limited protection for consumers with respect to the level or structure of electricity distribution use of system charges. It went on to propose interim arrangements for charging based on those already in place for Independent Gas Transporters (IGTs). With regard to ENL's application, these arrangements would limit the scope for overcharging for distribution use of system services by requiring that the licensee's charges for use of its distribution system to enable supply to domestic consumers do not exceed those charges that would be made by the distribution licence holder in whose distribution services area the network is located.

The majority of those respondents that discussed charging arrangements supported proposals to introduce charge restriction conditions. There was some concern as to whether the proposed arrangements would produce charges that adequately reflected underlying costs. In considering the most appropriate approach to setting charges for use of a network it is necessary to balance advantages of cost reflectivity against factors such as the disadvantages of increased complexity. Having site specific charges for network extensions would appear to be unduly complex and might hinder the development of supply competition for consumers connected to such networks. Given these

considerations and the views of respondents, in the case of this application it is appropriate to adopt the proposals for charge restriction conditions set out in the open letter of 31 May 2002.

Several respondents stressed the importance of encouraging the development of competition in the market for final connections and questioned whether the new charge restriction condition would be consistent with this. In so far as the condition provides for the equal treatment of all licence holders it would appear to promote competition between them. To the extent that there are different costs associated with different network developments then these can be taken into account by adjusting the upfront charges levied on the owners of these developments.

One respondent questioned whether it would be appropriate to introduce new charge restriction conditions without the provision of a disapplication procedure similar to that found in other charge restriction conditions. There is some merit in these arguments and for this applicant the proposed licence condition has been modified to include a disapplication procedure.

Quality of Service

At present there are a number of obligations in place on existing electricity distribution licence holders to ensure that Ofgem receives accurate and consistent information on their quality of service and to ensure that licensed distribution companies have incentives to deliver an appropriate level of service to consumers. Taken together these requirements provide important safeguards and Ofgem would expect to apply similar standards of performance to a new licensee as apply to existing distribution companies, although they may need to be tailored to reflect the size of a new entrant and other specific circumstances. These issues will be dealt with in the consultation paper to be published later this year.

In the interim it is important that Ofgem receives accurate and consistent information on the quality of service provided by a new licensee and that this information is comparable with that provided by existing distribution companies. Under section B SLC 5, a new distribution licensee will be required to produce a statement setting out the criteria they would use to measure their security and availability of supply and quality of service. As a minimum, Ofgem would expect a new licensee to record data on the number and duration of interruptions to supply and the number of short interruptions in line with the definitions set out in the RIGs. They will also be required to provide an annual report on performance within two months of the end of the financial year.

Respondents to the 31 May letter generally supported this approach and it is intended to go forward on this basis.

Financial Ring-Fencing

Existing licensed electricity distribution companies are typically part of larger groups of companies. In order to protect the licensed activities from adverse financial circumstances, including those that might arise elsewhere in the group, a number of financial ring fencing conditions have been developed and are now section C SLCs. These are:

- condition 43 –Restriction on Activity and Financial Ring Fencing;
- condition 44 –Availability of Resources;
- condition 45 –Undertaking from Ultimate Controller;
- condition 46 –Credit Rating of Licensee; and
- condition 47 –Indebtedness.

These conditions were designed, inter alia, to reduce the risk of financial failure and possible consequential disruption to the provision of electricity distribution services. Taken together these conditions provide important safeguards for the financial stability of the licensed company and so for protection of the interests of consumers. Nevertheless these conditions were designed bearing in mind the circumstances of those existing licence holders with distribution service area obligations. All the existing licence holders are relatively large companies. ENL is significantly smaller than the

existing licence holders. It might be more difficult for a smaller company to comply with SLC 46 as it requires the licensee to use all reasonable endeavours to ensure that at all times it retains an investment grade issuer credit rating. Therefore it is proposed to create a standard condition based on the existing SLC 46 but modified to allow Ofgem to give consent to alternative financial arrangements for compliance.

Alternative financial arrangements that Ofgem would consider giving consent to might include a formal and legally binding agreement from an entity that has and agrees to maintain an investment grade issuer credit rating. The agreement would typically be an undertaking given by a parent company in favour of its subsidiary. The parent would have to guarantee to make available to the subsidiary whatever financial resources as are from time to time necessary to ensure that the subsidiary is at all times in a position to meet its obligations in full as they fall due. This might be achieved for example by the subsidiary maintaining a minimum surplus of assets over liabilities and or a minimum level of liquidity. The licensee would need to be obliged to follow Ofgem's directions with respect to the enforcement of the undertaking.

There were a range of views expressed about financial ring fencing arrangements and about half of respondents supported the proposals. Other respondents recognised the importance of the financial stability of licensed electricity distribution companies, but suggested that in the event of financial failure another licensed operator should be required to take over the network. It is not clear that Ofgem would have powers to impose such arrangements and given the importance of ensuring that consumers retain access to electricity distribution services it is intended to retain the proposals for financial ring fencing.

Regulatory Accounts

As noted in the 31 May letter the proposals on financial ring-fencing (in particular restrictions on activity and financial ring fencing) should ensure that ENL's statutory accounts provide adequate information on the turnover, costs and assets associated with electricity distribution activities.

Definitions

Amendments have been proposed to the definitions contained within Section A standard condition 1. These modifications will remove, where possible, references to conditions in Section C of the licence. At present, it is expected that Section C will not be activated in the case of ENL. Therefore, the modified definitions will, where possible, refer to standard conditions contained within Section BA of the licence.

Process

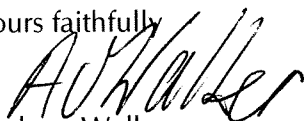
The 31 May 2002 letter envisaged introducing the above proposals by way of new special licence conditions. One respondent questioned whether it would be appropriate to introduce the proposals by way of new special conditions given that many of the obligations would be very similar to existing standard conditions. The respondent suggested that using the process envisaged by section 8A of the Electricity Act and introducing the conditions as new SLCs in a new distribution licence as this would provide a more robust process. In the light of these comments Ofgem has decided to adopt this approach with regard to ENL's application and attached to this open letter is a statutory consultation notice pursuant to section 8A of the Electricity Act. The intention is to create modified SLCs for ENL. As explained in the introduction this process will not change the licences of existing electricity distribution companies.

Responses to the statutory notice and consultation exercise should be received no later than **23 October** 2003 and sent to:

Gary Keane
Ofgem
9 Millbank
London
SW1P 3GE
E-mail gary.keane@ofgem.gov.uk

Tel 0207 901 7330

Yours faithfully

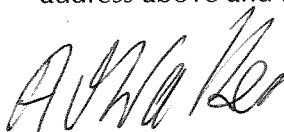
A handwritten signature in black ink, appearing to read 'A Walker', written over the typed name 'Andrew Walker'.

Andrew Walker
Director – Regulation & Financial Affairs

NOTICE UNDER SECTION 8A (3) OF THE ELECTRICITY ACT 1989

The Gas and Electricity Markets Authority ('the Authority') hereby gives notice pursuant to section 8A (3) of the Electricity Act 1989 ('the Act') as follows:

1. An application for an electricity distribution licence (the licence) under section 6(1) (c) of the Act has been received by the Authority from Energy Networks Limited (the applicant).
2. If the Authority decides to grant a licence to the applicant then the Authority proposes to modify the standard conditions of that licence as set out in the Annex to this notice.
3. The proposed modifications would involve amendments to Section A standard condition 1 and the addition to the licence of new section BA standard conditions BA1 (charging arrangements), BA2 (restriction on activity and financial ring fencing), BA3 (availability of resources), BA4 (undertakings from ultimate controller), BA5 (credit rating of licensee) and BA6 (indebtedness).
4. The purpose and effect of the modifications proposed is to put in place arrangements for charging restrictions and financial ring fencing designed to protect the interests of any consumers connected to the applicant's electricity distribution network. The amendments to the definitions contained within Section A standard condition 1 remove, where appropriate, references to conditions in Section C of the licence, which it is presently expected will not be activated for this applicant.
5. The reasons for the modifications were set out in open letters of 31 May 2002 and 24 September 2003.
6. A copy of the proposed modifications and the open letters of 31 May 2002 and - 24 September 2003 can be obtained (free of charge) from Gary Keane, Ofgem, 9 Millbank, London SW1P 3GE and are available on the Ofgem website (www.ofgem.gov.uk). Any representation or objection to the proposed modifications should be made on or before Thursday 23 October 2003 to the address above and marked for the attention of Gary Keane.



Andrew Walker
Director – Regulation & Financial Affairs
Authorised on behalf of the Gas and Electricity Markets Authority

24 September 2003

ANNEX TO NOTICE UNDER SECTION 8A OF THE ELECTRICITY ACT
1989

PART II. THE STANDARD CONDITIONS

SECTION A. INTERPRETATION, APPLICATION AND PAYMENTS

Condition 1. Definitions and Interpretation

[All definitions within the above condition remain the same save the following amendments]

1. In these standard conditions, unless the context otherwise requires:

“cross-default obligation”	for the purposes of standard condition BA6 (Indebtedness) only, has the meaning given in that condition.
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“distribution business”	means a business of the licensee, or in relation to sub-paragraphs (a) to (c) below, and except to the extent otherwise specified by the Authority in a direction to the licensee, any business of any affiliate or related undertaking of the licensee comprising: <ul style="list-style-type: none">(a) the distribution of electricity through the licensee’s distribution system, including any business in providing connections to such system;(b) metering point administration services pursuant to and in accordance with the Master Registration Agreement;(c) data transfer services;(d) the provision of metering equipment which, at the discretion of the licensee, may be metering equipment which is owned by him or by any person other than the person making the
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	<p>application;</p> <p>(e) the installation, commissioning, testing, repair, maintenance, removal and replacement of metering equipment;</p> <p>or any business ancillary thereto.</p>
"indebtedness"	for the purposes of standard condition BA6 (Indebtedness) only, has the meaning given in that condition.
"investment"	for the purposes of Section BA only, has the meaning given in standard condition BA2 (Restriction on Activity and Financial Ring Fencing).
"investment grade issuer credit rating"	for the purposes of Section BA only, has the meaning given in standard condition BA5 (Credit Rating of Licensee).
"Master Registration Agreement"	means the agreement of that title referred to and comprising such matters as are set out in standard condition 14 (Provision of the Metering Point Administration Service and Compliance with Master Registration Agreement) and standard condition 37 (The Metering Point Administration Service and the Master Registration Agreement).
"Metering Point Administration Service"	means the service to be established, operated and maintained by the licensee in accordance with standard condition 14 (Provision of the Metering Point Administration Service and Compliance with Master Registration Agreement).
"metering point administration services"	means the services of the Metering Point Administration Service established in accordance with

standard condition 14 (Provision of the Metering Point Administration Service and Compliance with Master Registration Agreement) or, where the context requires, in accordance with standard condition 37 (The Metering Point Administration Service and the Master Registration Agreement).

“permitted purpose”

for the purposes of Section BA only, has the meaning given in standard condition BA2 (Restriction on Activity and Financial Ring Fencing).

SECTION BA: SPECIFIC

Standard Condition BA 1: Charging Arrangements

1. The Licensee shall make available and continue to make available charges for the provision of use of system to any authorised supplier using the licensee's network to supply domestic customers.
2. The licensee's distribution use of system charges to domestic customers may vary according to the distribution services area of the licensed distributor within which domestic premises are connected to the licensee's distribution system.
3. The licensee shall set these charges so that, except with the prior written consent of the Authority, the standing charge, unit rate and any other component of charges shall not exceed the distribution use of system charges to equivalent domestic customers.
4. For the purposes of this condition distribution use of system charges to equivalent domestic customers are the distribution use of system charges made by the licensed distributor that has a Distribution Services Direction specifying the distribution services area where the domestic premises connected to the licensee's system are located.
5. The Authority may specify by direction, which of the distribution use of system charges made by the licensed distributor with Distribution Services Obligations for the distribution services area are relevant for the purposes of determining distribution use of system charges to equivalent domestic customers.

6. These charging arrangements shall have effect within this licence until such time and in such circumstances as are described in paragraphs 7 to 12 of this standard condition.
7. This condition shall cease to have effect (in whole or in part as the case may be) if the licence delivers to the Authority a disapplication request made in accordance with paragraph 8 of this standard condition or notice is given to the Authority by the licensee in accordance with either paragraph 11 or paragraph 12 of this standard condition.
8. A disapplication request shall:
 - (i) be in writing addressed to the Authority
 - (ii) specify the paragraph or paragraphs of this standard condition to which the request relates; and
 - (iii) state the date (being not earlier than the date specified in paragraph 10) of this standard condition from which the licensee wishes the Authority to agree that the conditions shall cease to have effect, (the disapplication date).
9. The licensee may withdraw a disapplication request at any time.
10. Save where the Authority otherwise consents in writing, no disapplication following delivery of a disapplication request pursuant to paragraph 8 of this standard condition shall have effect until a date being the later of:
 - (a) not less than 18 months after delivery of the disapplication request; and
 - (b) 31 March 2007.
11. If the Authority has not made a reference to the Competition Commission under section 12 of the Electricity Act relating to the modification of this standard condition or the part

or parts thereof specified in the disapplication request before the beginning of the period of 12 months which will end with the disapplication date and the licensee has not withdrawn this disapplication request, the licensee may deliver a written notice to the Authority terminating the application of this standard condition or the part or parts thereof specified in the disapplication request with effect from the disapplication date or such earlier date to which the Authority has given its consent under paragraph 10.

12. If the Competition Commission makes a report on a reference made by the Authority relating to the modification of this standard condition or the part or parts thereof specified in the disapplication request and such report does not include a conclusion that the cessation of such revenue restrictions in this standard condition, in whole or in part, operates or may be expected to operate against the public interest, the licensee may within 30 days after the publication of the report by the Authority in accordance with section 13 of the Act deliver to the Authority written notice terminating the application of this standard condition or the part or parts thereof specified in the disapplication request with effect from the disapplication date.

Standard Condition BA2: Restriction on Activity and Financial Ring Fencing

1. Save as provided by paragraphs 3 and 4, the licensee shall not conduct any business or carry on any activity other than the distribution business.
2. The licensee shall not without the prior written consent of the Authority hold or acquire shares or other investments of any kind except:
 - (a) shares or other investments in a body corporate the sole activity of which is to carry on business for a permitted purpose; or
 - (b) shares or other investments in a body corporate which is a subsidiary of the licensee and incorporated by it solely for the purpose of raising finance for the distribution business; or
 - (c) investments acquired in the usual and ordinary course of the licensee's treasury management operations, subject to the licensee maintaining in force, in relation to those operations, a system of internal controls which complies with best corporate governance practice as required (or in the absence of any such requirement recommended) from time to time for listed companies in the United Kingdom.
3. Subject to the provisions of paragraph 2 nothing in this condition shall prevent:
 - (a) any affiliate in which the licensee does not hold shares or other investments from conducting any business or carrying on any activity;
 - (b) the licensee from holding shares as, or performing the supervisory or management functions of, an investor in respect of any body corporate in which it holds an interest consistent with the provisions of this licence;
 - (c) the licensee from performing the supervisory or management functions of a holding company in respect of any subsidiary; or
 - (d) the licensee from carrying on any business or conducting any activity to which the Authority has given its consent in writing;
4. Nothing in this condition shall prevent the licensee or an affiliate or related undertaking of the licensee in which the licensee holds shares or other investments (a 'relevant associate') conducting de-minimis business as defined in this paragraph so long as the limitations specified in this paragraph are complied with.

- (a) For the purpose of this paragraph “ de-minimis business” means any business or activity carried on by the licensee or a relevant associate or relevant associates other than:
 - (i) the distribution business; and
 - (ii) any other business activity to which the Authority has given its consent in writing in accordance with paragraph 3(d).
- (b) The licensee or a relevant associate may carry on de-minimis business provided that the relevant associate carries on no other business except activities of the distribution business and business activities authorised by the Authority under paragraph 3(d), and neither of the following limitations is exceeded, namely:
 - (i) the aggregate turnover of all the de-minimis business carried on by the licensee and all its relevant associates does not in any period of twelve months commencing on 1 April of any year exceed 2½% of the aggregate turnover of the distribution business as shown by the most recent audited accounting statements of the licensee
 - (ii) the aggregate amount (determined in accordance with sub-paragraph (d) below) of all investments made by the licensee and all its relevant associates in their de-minimis business or de-minimis businesses does not at any time after the date this condition takes effect in this licence exceed 2½% of the sum of share capital in issue, share premium and consolidated reserves of the licensee as shown by its most recent audited historical cost financial statements then available.
- (c) For the purpose of sub-paragraph (b) of this paragraph, “investment” means any form of financial support or assistance given by or on behalf of the licensee or a relevant associate for the de-minimis business whether on a temporary or permanent basis including (without limiting the generality of the foregoing) any commitment to provide any such support or assistance in the future.
- (d) At any relevant time, the amount of an investment shall be the sum of:
 - (i) the value at which such investment was included in the audited historical cost balance sheet of the licensee or a relevant associate as at its latest accounting reference date to have occurred prior to the date this condition takes effect in this licence (or, where the investment was not so included, zero);

- (ii) the aggregate gross amount of all expenditure (whether of a capital or revenue nature) howsoever incurred by the licensee or a relevant associate in respect of such investment in all completed accounting reference periods since such accounting reference date; and
- (iii) all commitments and liabilities (whether actual or contingent) of the licensee or a relevant associate relating to such investment outstanding at the end of the most recently completed accounting reference period.

5. In this condition :

“permitted purpose”

means the purpose of all or any of the following:

- (a) the licensee’s distribution business or any other business or activity within the limits of paragraph 4;
- (b) any business or activity to which the Authority has given its consent in writing in accordance with paragraph 3 (d);and
- (c) without prejudice to the generality of sub-paragraph (a), any payment or transaction lawfully made or undertaken by the licensee for a purpose within sub-paragraphs 1(b)(i) to (vii) of standard condition BA6.

Standard Condition BA3: Availability of Resources

1. The licensee shall at all times act in a manner calculated to secure that it has available to it all such resources, including (without limitation) management and financial resources, personnel, fixed and moveable assets, rights, licences, consents and facilities on such terms and with all such rights as shall ensure that it is at all times able:
 - (a) to properly and efficiently to carry on the distribution business; and
 - (b) to comply in all respects with its obligations under this licence and such obligations under the Act as apply to the distribution business including, without limitation, its duty to develop and maintain an efficient, co-ordinated and economical system of electricity distribution.

2. The licensee shall submit a certificate to the Authority, approved by a resolution of the board of directors of the licensee and signed by a director of the licensee pursuant to that resolution. Such certificate shall be submitted in June of each year. Each certificate shall be in one of the following forms:
 - (a) "After making enquiries, the directors of the licensee have a reasonable expectation that the licensee will have available to it, after taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, sufficient financial resources and financial facilities to enable the licensee to carry on the distribution business for a period of 12 months from the date of this certificate."
 - (b) "After making enquiries, the directors of the licensee have a reasonable expectation, subject to what is said below, that the licensee will have available to it, after taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, sufficient financial resources and financial facilities to enable the licensee to carry on the distribution business for a period of 12 months from the date of this certificate. However, they would like to draw attention to the following factors which may cast doubt on the ability of the licensee to carry on the distribution business."
 - (c) "In the opinion of the directors of the licensee, the licensee will not have available to it sufficient financial resources and financial facilities to enable the

licensee to carry on the distribution business for a period of 12 months from the date of this certificate.”

3. The licensee shall submit to the Authority with that certificate a statement of the main factors which the directors of the licensee have taken into account in giving that certificate.
4. The licensee shall inform the Authority in writing immediately if the directors of the licensee become aware of any circumstance which causes them no longer to have the reasonable expectation expressed in the then most recent certificate given under paragraph 2.
5. The licensee shall use its best endeavours to obtain and submit to the Authority with each certificate provided for in paragraph 2 a report prepared by its auditors and addressed to the Authority stating whether or not the auditors are aware of any inconsistencies between, on the one hand, that certificate and the statement submitted with it and, on the other hand, any information which they obtained during their audit work.
6. The directors of the licensee shall not declare or recommend a dividend, nor shall the licensee make any other form of distribution within the meaning of section 263 of the Companies Act 1985, unless prior to the declaration, recommendation or making of the distribution (as the case may be) the licensee shall have issued to the Authority a certificate complying with the following requirements of this paragraph.
 - (a) The certificate shall be in the following form:

“After making enquiries, the directors of the licensee are satisfied:

 - (i) that the licensee is in compliance in all material respects with all obligations imposed on it by standard condition 24 (Provision of Information to the Authority), standard condition BA2 (Restriction on Activity and Financial Ring-fencing), standard condition BA3 (Availability of Resources), standard condition BA4 (Undertaking from Ultimate Controller), standard condition BA5 (Credit Rating) and paragraph 1 of standard condition BA6 (Indebtedness) of the licence; and
 - (ii) that the making of a distribution of [] on [] will not, either alone or when taken together with other circumstances reasonably foreseeable at

the date of this certificate, cause the licensee to be in breach to a material extent of any of these obligations in the future.

- (b) The certificate shall be signed by a director of the licensee and approved by a resolution of the board of directors of the licensee passed not more than 14 days before the date on which the declaration, recommendation or payment will be made.
- (c) Where the certificate has been issued in respect of the declaration or recommendation of a dividend, the licensee shall be under no obligation to issue a further certificate prior to payment of that dividend provided such payment is made within six months of that certificate.

Standard Condition BA4: Undertaking from Ultimate Controller

1. The licensee shall procure from each company or other person which the licensee knows or reasonably should know is at any time an ultimate controller of the licensee a legally enforceable undertaking in favour of the licensee in the form specified by the Authority that that ultimate controller ("the covenantor") will refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of, or is controlled by, the covenantor (other than the licensee and its subsidiaries) will refrain from any action, which would then be likely to cause the licensee to breach any of its obligations under the Act or this licence. Such undertaking shall be obtained within 7 days of the company or other person in question becoming an ultimate controller and shall remain in force for as long as the licensee remains the holder of this licence and the covenantor remains an ultimate controller of the licensee.
2. The licensee shall:
 - (a) deliver to the Authority evidence (including a copy of each such undertaking) that the licensee has complied with its obligation to procure undertakings pursuant to paragraph 1;
 - (b) inform the Authority immediately in writing if the directors of the licensee become aware that any such undertaking has ceased to be legally enforceable or that its terms have been breached; and
 - (c) comply with any direction from the Authority to enforce any such undertaking;and shall not, save with the consent in writing of the Authority, enter (directly or indirectly) into any agreement or arrangement with any ultimate controller of the licensee or of any of the subsidiaries of any such corporate ultimate controller (other than the subsidiaries of the licensee) at a time when,
 - (i) an undertaking complying with paragraph 1 is not in place in relation to that ultimate controller; or
 - (ii) there is an unremedied breach of such undertaking; or
 - (iii) the licensee is in breach of the terms of any direction issued by the Authority under paragraph 2 of this condition.

Standard Condition BA5: Credit Rating of Licensee

1. The licensee shall use all reasonable endeavours to ensure that the licensee maintains at all times an investment grade issuer credit rating, or with the prior written permission of the Authority, any such arrangements as the Authority considers appropriate.
2. In this condition:
“investment grade issuer credit rating” means:
 - (a) an issuer rating of not less than BBB- by Standard & Poor’s Ratings Group or any of its subsidiaries or a corporate rating of not less than Baa3 by Moody’s Investors Service, Inc. or any of its subsidiaries or such higher rating as shall be specified by either of them from time to time as the lowest investment grade credit rating, or
 - (b) an equivalent rating from any other reputable credit rating agency which, in the opinion of the Authority, notified in writing to the licensee, has comparable standing in the United Kingdom and the United States of America.

Standard Condition BA6: Indebtedness

1. In addition to the requirements of standard condition 29 (Disposal of Relevant Assets), the licensee shall not without the prior written consent of the Authority (following the disclosure by the licensee of all material facts):
 - (a) create or continue or permit to remain in effect any mortgage, charge, pledge, lien or other form of security or encumbrance whatsoever, undertake any indebtedness to any other person or enter into any guarantee or any obligation otherwise than:
 - (i) on an arm's length basis;
 - (ii) on normal commercial terms;
 - (iii) for a permitted purpose; and
 - (iv) (if the transaction is within the ambit of standard condition 29 (Disposal of Relevant Assets)) in accordance with that condition;
 - (b) transfer, lease, license or lend any sum or sums, asset, right or benefit to any affiliate or related undertaking of the licensee otherwise than by way of:
 - (i) a dividend or other distribution out of distributable reserves;
 - (ii) repayment of capital;
 - (iii) payment properly due for any goods, services or assets provided on an arm's length basis and on normal commercial terms;
 - (iv) a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis, on normal commercial terms and made in compliance with the payment condition;
 - (v) repayment of or payment of interest on a loan not prohibited by sub-paragraph (a);
 - (vi) payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received ; or
 - (vii) an acquisition of shares or other investments in conformity with paragraph 2 of standard condition BA2 (Restriction on Activity and

Financial Ring Fencing) made on an arm's length basis and on normal commercial terms;

- (c) enter into an agreement or incur a commitment incorporating a cross-default obligation; or
- (d) continue or permit to remain in effect any agreement or commitment incorporating a cross-default obligation subsisting at the date this condition takes effect in this licence, save that the licensee may permit any cross-default obligation in existence at that date to remain in effect for a period not exceeding twelve months from that date, provided that the cross-default obligation is solely referable to an instrument relating to the provision of a loan or other financial facilities granted prior to that date and the terms on which those facilities have been made available as subsisting on that date are not varied or otherwise made more onerous.
- (e) the provisions of sub-paragraphs (c) and (d) of this paragraph shall not prevent the licensee from giving any guarantee permitted by and compliant with the requirements of sub-paragraph (a).
- (f) the payment condition referred to in sub-paragraph (b)(iv) is that the consideration due in respect of the transaction in question is paid in full when the transaction is entered into unless either:
 - (i) the counter-party to the transaction has and maintains until payment is made in full an investment grade issuer credit rating, or
 - (ii) the obligations of the counter-party to the transaction are fully and unconditionally guaranteed throughout the period during which any part of the consideration remains outstanding by a guarantor which has and maintains an investment grade issuer credit rating.

2. In this condition:

"cross-default obligation"

means a term of any agreement or arrangement whereby the licensee's liability to pay or repay any debt or other sum arises or is increased or accelerated or is capable of arising, increasing or of acceleration by reason of a default

(howsoever such default may be described or defined) by any person other than the licensee, unless:

- (i) that liability can arise only as the result of a default by a subsidiary of the licensee,
- (ii) the licensee holds a majority of the voting rights in that subsidiary and has the right to appoint or remove a majority of its board of directors, and
- (iii) that subsidiary carries on business only for a purpose within paragraph (a) of the definition of permitted purpose.

“indebtedness”

means all liabilities now or hereafter due, owing or incurred, whether actual or contingent, whether solely or jointly with any other person and whether as principal or surety, together with any interest accruing thereon and all costs, charges, penalties and expenses incurred in connection therewith.