

Qualifying bidders
Preferred bidders
All offshore transmission owners
Other interested parties

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Date: 22 October 2014

Dear Colleague,

Update on our position regarding alternative credit rating arrangements for offshore transmission owners ("OFTOs")

OFTOs are appointed by a competition process run by Ofgem. On 13 October 2010 we published an open letter¹ (the "letter") regarding alternative credit rating arrangements for OFTOs. In the letter we outlined that certain alternatives may suit the circumstances of smaller companies while protecting the interests of consumers. We also proposed three indicative alternative arrangements that we considered appropriate for OFTOs at the time. Since the publication of the letter standard condition E11 'Credit Rating of Licensee' has changed. This letter updates our position on alternative credit rating arrangements in order to be consistent with the current drafting of standard condition E11 and consent we have given to offshore transmission owners to date.

1. Standard condition E11 'Credit Rating of Licensee' (the "Condition") of the electricity transmission licence (the "Licence") now requires licensees to maintain at all times:
 - a) an investment grade issuer credit rating²;
 - b) investment grade instrument credit ratings for debt instruments that it has issued and whose aggregate nominal value is at least 75% of a figure equating to the licensee's total assets minus total liabilities as shown in its most recent statutory accounts; or
 - c) such alternative arrangements to which the Authority has given its consent in writing.
2. We note that, since the publication of the 2010 letter, 'investment grade instrument rating' has been added to the Condition as outlined above. In the letter we noted that an investment grade instrument rating was one of the alternative credit rating arrangements that would suit the circumstances of OFTOs.
3. We consider that, despite the above change to the Condition, other alternative credit arrangements specified in the letter may still provide a proportionate and practical

¹ See <https://www.ofgem.gov.uk/ofgem-publications/50810/open-letter-regarding-alternative-credit-rating-arrangements-offshore-transmission-owners-oftos.pdf>

² As defined in the Licence

way of achieving the policy aims of the Condition³. These alternative arrangements are set out in annex 1 and illustrated in annex 2. They are consistent with arrangements applied both onshore and offshore to date, and have been informed both by our previous policy position and experience to date in granting offshore transmission licences.

4. These alternative arrangements are indicative only and do not prevent preferred bidders or OFTOs proposing new alternative arrangements which the Authority will consider on their own merits. Each preferred bidder or OFTO will need to propose alternative arrangements for the Authority to consider consenting to if they wish to make use of any of the options outlined below.
5. In order for any alternative arrangements to constitute licence compliance a licensee would need the Authority's written consent and we may request draft copies of any agreements (keep well⁴, escrow, on demand bond, letter of credit) as part of the process when considering the application for alternative arrangements.
6. Cash operating costs are projected operating costs for six months as agreed with Ofgem on a six monthly basis and include asset replacement costs, but are not intended to include interest payable or repayment of debt. Note however that this is indicative only and may change upon consideration of the facts and circumstances of a particular applicant. A pro-forma is attached in annex 3 to indicate the likely form of the reporting requirements and to give further guidance on the costs which are to be included.
7. Once appointed, preferred bidders are asked to contact Ofgem via the transactions email address (offshoretransactions@ofgem.gov.uk) with specific requests for alternative credit rating arrangements if they are sought.
8. If you would like to discuss any aspect of these arrangements then please do not hesitate to contact Neil Roberts, Senior Manager, Financial Analysis (Tel: 0203 263 2727).

Yours faithfully

Stephen Beel
Associate Director, Offshore Transmission

³ As set out in the Review of the 'Ring Fence' Conditions in Network Operator Licences – see http://www.ofgem.gov.uk/Networks/Policy/Documents/IA_Ring_Fence_Review_3%20Mar%2010_final.pdf

⁴ A keep well agreement is a legally enforceable undertaking from the parent company that it will provide such financial support as is necessary to its subsidiary for the term of the agreement.

Annex 1: Alternative credit rating arrangements which the Authority considers are likely to be suitable for OFTOs⁵

Option 1

1. If the parent company does not have an investment grade credit rating then the licensee must maintain:
 - i. A keep well agreement with the parent company of the licensee such that the parent company provides a legally enforceable undertaking to provide cash to the amount specified below,

and

 - ii. Cash in escrow, on demand bond or letter of credit with a third party such that the licensee is the recipient of the funds when called. The amount of cash to be available to the licensee under any of these arrangements is specified below. In the case of an on demand bond or letter of credit the counterparty providing the guarantee must hold at least an A- credit rating and be resident in a country with at least an A credit rating.
2. The amount available to the licensee under both i. and ii. above should be no less than six months' cash operating costs and six months' asset replacement costs as reported to the Authority every six months on the pro-forma supplied.
3. The trigger event for drawing down the escrow account or calling the bond or letter of credit will be a failure by the parent company to meet a call under the keep well agreement. The licensee is required to notify Ofgem as soon as a call is made on cash reserve (e.g. monies held in the escrow/bond/letter of credit), and in any event no more than 24 hours after the call is made. As soon as the escrow account/bond/letter of credit is wholly or partially drawn the parent company will be obliged to arrange for full re-instatement of the escrow/bond/letter of credit so that the full amount is in place at the start of the subsequent six-month period and must notify Ofgem each week that elapses without sufficient funds being in place.

Option 2

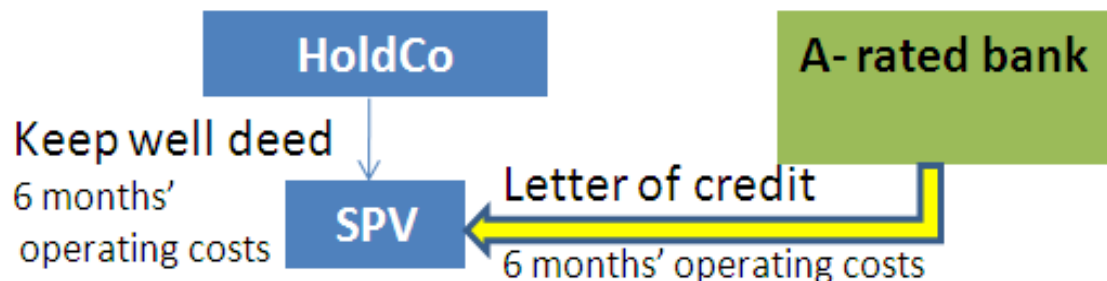
1. The licensee must maintain a keep well agreement with the parent company of the licensee such that the parent company provides a legally enforceable undertaking to provide cash to the amount specified below and that parent company must itself have an investment grade credit rating (either issuer or instrument based).
2. The amount available to the licensee under the keep well should be no less than six months' cash operating costs and six months' asset replacement costs as reported to the Authority every six months on the pro-forma supplied.
3. In the event that the parent company fails to meet a call under the keep well agreement the licensee is required to notify Ofgem, and in any event no more than 24 hours after the call is made, of this event. As soon as the keep well is wholly or partially drawn upon then the parent company will be obliged to arrange for full re-instatement of the keep well agreement so that the full amount is in place at the start of the subsequent six-month period and must notify Ofgem each week that elapses without a sufficient agreement being in place.

⁵ Note that this does not fetter the Authority's right to consider alternative arrangements or refuse particular applications for alternatives which are not considered appropriate when considering the facts of the situation.

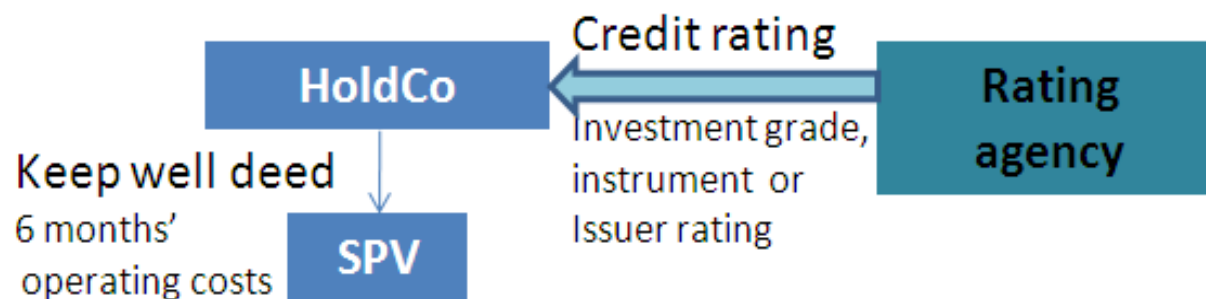
Annex 2: Illustration of the potential alternative arrangements set out in annex 1

Note: These diagrams are to aid understanding only and do not change the potential alternative arrangements set out in annex 1 in the event that any inconsistency is identified.

Option 1



Option 2



Annex 3: Example reporting pro-forma

OFTO Credit Rating - Alternative Arrangements Data

Licensee Name:			
Reporting Date 15 September 2015:	6 Months Ending		
	31 March 2015	31 March 2015	
	(Actual £)	(Forecast £)	
Operating & Asset Replacement Costs			
Ongoing O&M			
Reactive maintenance			
Insurance costs			
SPV Management			
Accounting			
Legal			
Licence fees			
Network rates			
Crown Estate lease costs			
Other rates			
Office & Property Costs			
Travel & Subsistence			
IT, Telephony, Printing and Stationery			
Replacement expenditure (not capitalised)			
<Other items expensed through the P&L - over-type>			
<Other items expensed through the P&L - over-type>			
<Other items expensed through the P&L - over-type>			
<Other items expensed through the P&L - over-type>			
Total P&L payments	0		0
Existing network assets - repair/replacement (capitalised)			
Escrow / Guarantee Amount (£)	0		0

Memo items

Finance costs (net interest payable)		
Tax		

Current arrangements in place to satisfy escrow requirement with expiry date and renewal details:

Please note: Ofgem may require original documentary evidence of the escrow / guarantee arrangements described above