

Company Directive


FINANCIAL & ACCOUNTING POLICY

POLICY DOCUMENT: FI 07/01/05/04

**Financial control –
Inter-business loans and similar agreements**

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Approved by: 
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Introduction

- 1.1 This document outlines Western Power Distribution (WPD) group policy on how inter-business loans are set-up and reported. Group cross-charges generally are dealt with in POL: FI 07 01 03. This policy also represents best practise for all inter business loans or similar agreements to ensure consistent regulatory, accounting and taxation treatment.

1.0 Policy detail

- 2.1 Inter-business loans or similar arrangements which involve the regulated electricity businesses must comply with the conditions of the Electricity Distribution Licences, and where applicable the specific provisions within the Memorandum and Articles of Association of PPL WW Holdings Limited.
- 2.2 For regulatory reporting, agreements are reported in accordance with the Regulatory Accounting Guidelines.
- 2.3 For statutory reporting, inter-business loans and similar agreements are reported in line with Financial Reporting Standard 8.

3.0 Background

- 3.1 For the purposes of this document, “loan and similar agreements” refers to loans of cash, assets, rights or benefits; mortgages, charges, pledges, liens, or any other form of security; leases; or licenses. NB: Pledges and guarantees are also dealt with by POL: FI 10 01 02.
- 3.2 Condition 41 (previously Condition 47) of the Electricity Distribution Licence deals with the restrictions on indebtedness of the regulated distribution businesses. For reference, the Condition is attached to POL: FI 10 01 02. In addition, Condition 29 (previously Condition 43) deals with restriction on activity and financial ring fencing, and is attached to POL: FI 07 01 04 for reference.
- 3.3 Certain restrictions are also included within the Memorandum and Articles of Association of PPL WW Holdings Limited, copies of which are held by Legal Services (the Memorandum and Articles of Association form part of the Standards and Management policy LE2/1).
- 3.4 In order to comply with the requirements of Condition 41 (and to avoid having to obtain the prior authority of Ofgem for a transaction), all loans or similar transactions to or from the regulated businesses must be:
 - (a) on an arm’s length basis ;
 - (b) on normal commercial terms;
 - (c) for a permitted purpose; and
 - (d) if the transaction is within the ambit of standard condition 26 (Disposal of Relevant Assets) it must comply with the requirements of that condition.

Note: “permitted purposes” are defined in the conditions to the electricity distribution licence. As illustrations only, normal commercial terms would imply that commercial interest rates should be charged on inter-business loans, and commercial rentals paid for leased items.

- 3.5 The Licensees must not transfer, lease, license or lend any sum or sums, asset, right or benefit to any Affiliate or Related Undertaking of the licensee except by way of any of the following transactions:
- (a) a dividend or other distribution out of distributable reserves; or
 - (b) a repayment of capital; or
 - (c) a payment properly due for any goods, services or assets provided on an arm’s length basis and on normal commercial terms; or
 - (d) a transfer, lease, licence or loan of any sum or sums, asset, right or benefit that is on an arm’s length basis, on normal commercial terms and is made in compliance with the payment condition described in paragraph 41.4; or
 - (e) a repayment of, or payment of interest on a loan not prohibited by paragraph 41.2; or
 - (f) 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
 - (g) an acquisition of shares or other investments in conformity with paragraph 2 and 3 of standard condition 29 (Restriction on Activity and Financial Ring Fencing of the Distribution Business) and is made on an arm’s length basis and on normal commercial terms,
- 3.6 The payment condition referred to in paragraph 3.5(d) is that the consideration due in respect of the transaction in question must be paid in full when the transaction is entered into unless either:
- (a) the counter-party to the transaction has, and maintains until payment is made in full, an Investment Grade Issuer Credit Rating, or
 - (b) 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.
- 3.7 PPL WW Holdings Limited and PPL WEM Holdings plc have entered into Guarantees for any “permitted purpose” loan involving WPD (South West), WPD (South Wales), WPD (East Midlands) or WPD (West Midlands).
- 3.8 A list showing the current categorisation of the Group Companies is included as an appendix to the Inter Group Facility Agreement; a copy of which is held by Legal Services.
- 3.9 Commercial terms are based on the rating of the borrower and apply Libor or Base Rate as appropriate according to the loan term. The additional margin applied is based on the current level of spreads in the market.

- 3.10 Formally approved, written agreements are required for each inter-business loan or similar agreement for all Group inter-company indebtedness. This is administered by the Treasury Operations Manager.

4.0 Monitoring and housekeeping

- 4.1 To provide a crucial safeguard against any indebtedness to non “permitted companies” being created and thus a breach of the Licence, a reconciliation of the internal debit and credit balances is to be carried out on a monthly basis to ensure that a swift identification is made of any net balances, or of requested payments that would lead to balances, that would constitute unauthorised Loans. In addition:
- (a) All managers responsible for the affiliate companies need to be aware of this tighter restriction on expenditure with regard to “non-permitted” balances.
 - (b) The Accountant responsible for the books of the individual companies should monitor the net inter-company position as part of their monthly procedures so that any correcting entries can be applied within the month.
 - (c) A further check on each company position will be undertaken by Treasury utilising the Inter Company matrix which is completed following the second run of Safire. If any balances are identified as being an issue at this stage, the necessary course of action must be taken to rectify the situation within the following accounting period.
- 4.2 When there is a question about the interpretation of a law or regulation, clarification must be sought, in line with POL: ER19, under WPD’s Legal Compliance Programme.
- 4.3 All agreements should be reviewed and approved by Legal Services, the Financial Accounting Manager, Treasury and the Regulatory and Government Affairs Team, in addition to the managers of any affected managed units, in line with delegated authority limits within POL: FI 07 02 04.

APPENDIX A

SUPERSEDED DOCUMENTATION

FI 07/01/05 dated September 2003
FI 07/01/05/1 dated August 2005
FI 07/01/05/02 dated November 2008
FI 07/01/05/03 dated June 2011

APPENDIX B

ASSOCIATED DOCUMENTATION

[POL: FI 07 01 03](#) - [Group cross-charging](#)
[POL: FI 07 01 04](#) - [De-minimis activities](#)
[POL: FI 07 02 04](#) - [Relating to Financial Authority Levels](#)
[POL: FI 10 01 02](#) - [Pledges and guarantees](#)
[POL: ER19](#) - [Legal Compliance Programme – Statement of Policy](#)
Regulatory Condition 29 - Restriction on Activity and Financial Ring Fencing
Regulatory Condition 41 - Indebtedness
POL: LE 2/1 - Standards and Management

APPENDIX C

POLICY IMPACT

Tighter controls on inter company lending

APPENDIX D

POLICY IMPLEMENTATION

Modified month end models created to monitor net balances.

APPENDIX E

KEY WORDS

Inter-business loans, regulated distribution businesses, restriction, reporting