Dutch-Based Network Operator Alliander Proposed Junior Subordinated Notes Assigned 'A' Issue Rating

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- We are revising the equity content assessment on Dutch-based electricity and gas distribution network operator Alliander N.V.'s existing €500 million subordinated perpetual capital securities, issued in November 2010, to "minimal" from "intermediate."
- The company is proposing to tender its existing capital securities and simultaneously replace them with new perpetual capital securities. We assess the proposed securities as having "intermediate" equity content.
- We are assigning our 'A' issue rating to the proposed securities to reflect their subordination and optional deferability.

LONDON (Standard & Poor's) Nov. 19, 2013--Standard & Poor's Ratings Services today assigned its 'A' issue rating to the proposed perpetual, optionally deferrable, and subordinated hybrid capital securities to be issued by Dutch electricity and gas distribution network operator Alliander N.V. (the issuer; AA-/Stable/A-1+). The issuer intends to use the proceeds to tender and replace its existing €500 million subordinated perpetual capital securities, issued in November 2010.

We have revised our equity content assessment on the existing €500 million subordinated perpetual capital securities to "minimal" from "intermediate." We understand that the issuer has not secured an amendment to its replacement capital covenant (RCC). We view the existing hybrid instrument as lacking permanence due to the fact that the securities include a material 100-basis-point step-up in November 2020, which is not adequately mitigated by the RCC at the current rating level.

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We consider the new proposed securities to have "intermediate" equity content until their first call date in 2018 because they meet our hybrid capital criteria in terms of their subordination, permanence, and optional deferability during this period.

We arrive at our 'A' issue rating on the proposed securities by notching down from our 'aa-' stand-alone credit profile (SACP) on Alliander N.V. The two-notch differential between the issue rating and the SACP reflects our notching methodology, which calls for:

- A one-notch deduction for subordination because the corporate credit rating on Alliander is investment grade (that is, 'BBB-' or above); and
- An additional one-notch deduction for payment flexibility to reflect that the deferral of interest is optional.

The notching of the proposed securities reflects our view that there is a relatively low likelihood that the issuer will defer interest. Should our view change, we may increase the number of downward notches that we apply to the issue rating.

In addition, to reflect our view of the intermediate equity content of the proposed securities, we allocate 50% of the related payments on these securities as a fixed charge and 50% as equivalent to a common dividend, in line with our hybrid capital criteria. The 50% treatment of principal and accrued interest also applies to our adjustment of debt.

KEY FACTORS IN OUR ASSESSMENT OF THE INSTRUMENTS' PERMANENCE

Although the proposed securities are perpetual, they can be called at any time for tax, rating, or accounting events. Furthermore, the issuer can redeem them for cash as of their first call date five years after issuance and every coupon payment date thereafter. The issuer is also free to buy back the securities on the open market at any time, which we see as negative for equity content. This is partly mitigated by the intent to replace the security, if such repurchases exceed more than 10% in any 12 month period, or more than 25% over a period of 10 years. Furthermore, we see the repurchase as unlikely in the context of Alliander's strategic plans and investment requirements.

We understand that the interest to be paid on the proposed securities will increase by 25 basis points 10 years from issuance, and by a further 75 basis points 20 years after the first call date. We consider the cumulative 100 basis points as a material step up, which is currently unmitigated by any commitment to replace the respective instruments at that time. This step up provides an incentive for the issuer to redeem the securities on their first call date.

Consequently, in accordance with our criteria, we will no longer recognize the instruments as having "intermediate" equity content after the first call date, because the remaining periods until the economic maturity would, by then, be less than 20 years. However, we classify the instrument's equity content as intermediate until its first call date, as long as we believe that the loss of the beneficial "intermediate" equity content treatment will not cause the issuer to call the instrument at that point. The issuer's willingness to maintain or replace the instrument in the event of a reclassification of equity content to "minimal" is underpinned by its statement of intent.

KEY FACTORS IN OUR ASSESSMENT OF THE INSTRUMENTS' DEFERABILITY

In our view, the issuer's option to defer payment on the proposed securities is discretionary. This means that the issuer may elect not to pay accrued interest on an interest payment date because it has no obligation to do so. However, any outstanding deferred interest payment will have to be settled in cash if Alliander declares or pays an equity dividend or interest on equally ranking securities, and if Alliander redeems or repurchases shares or equally ranking securities. We see this as a negative factor. That said, this condition remains acceptable under our methodology because once the issuer has settled the deferred amount, it can still choose to defer on the next interest payment date.

The issuer retains the option to defer coupons throughout the instruments' life. The deferred interest on the proposed securities is cash cumulative, and will ultimately be settled in cash.

KEY FACTORS IN OUR ASSESSMENT OF THE INSTRUMENTS' SUBORDINATION

The proposed securities (and coupons) are intended to constitute direct, unsecured, and subordinated obligations of the issuer, ranking senior to their common shares.

RELATED CRITERIA AND RESEARCH

All articles listed below are available on RatingsDirect.

- Methodology and Assumptions: Assigning Equity Content to Corporate Entity and North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

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