

EXPLANATORY MEMORANDUM TO

THE WATER INDUSTRY (SPECIAL ADMINISTRATION) REGULATIONS 2024

2024 No. XXXX

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

- 2.1 The purpose of this statutory instrument is to update the special administration regime for water industry companies (which means a company of a kind mentioned in section 23(1) of the Water Industry Act 1991 (WIA)) in light of developments in the general insolvency and restructuring legislative regimes since the water industry special administration (WISAR) regime was introduced.
- 2.2 These Regulations apply, disapply, modify and make provisions similar to, and in place of insolvency provisions as they apply in relation to water industry companies and special administration orders made in respect of those water industry companies under the WIA which includes licensed infrastructure providers. These Regulations make general and specific modifications to the Insolvency Act 1986 and other enactments about insolvency. These Regulations adapt Parts 26 and 26A of the Companies Act 2006 via specific modifications for the purpose of the WISAR, amend section 26 of the WIA and amend Schedule 1 to the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013.
- 2.3 A commencement order will be made to commence paragraph 6 of Schedule 5 to the Flood and Water Management Act 2010 in order to apply Schedule B1 of the Insolvency Act 1986 to the WISAR and replace Schedule 3 to the WIA. The specific modifications to Schedule B1 made by these Regulations are required to apply those provisions to water industry companies undergoing special administration.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

4. Extent and Territorial Application

- 4.1 The extent of this instrument (that is, the jurisdiction which the instrument forms part of the law of) is England and Wales.
- 4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales.

5. European Convention on Human Rights

- 5.1 Robbie Moore MP, Parliamentary Under Secretary of State for Defra has made the following statement regarding Human Rights:

“In my view the provisions of the Water Industry (Special Administration) Regulations 2024 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 The Secretary of State makes these Regulations with the consent of the Welsh Ministers and in exercise of the powers conferred by sections 23(3A), 23(2E) and 213(2)(e) and (f) of the WIA.

7. Policy background

What is being done and why?

- 7.1 Special administration is a process in which the objectives under a normal administration are modified to include public interest objectives. The process typically enables an insolvent company, which provides vital public services (e.g., water, energy, rail) to be put into special administration with a requirement that the public service will be provided pending rescue or transfer to new owners. This contrasts to a normal administration, where the appointed administrator is generally focused on the creditors' interests. The Government prepares for all eventualities to ensure the uninterrupted provision of vital public services. There is a high bar for implementing a SAR and it is a tool to be used when other options have been exhausted.
- 7.2 There is no universal special administration regime (SAR) legislative framework, rather each vital public service is governed by their own distinct SAR, e.g., the water industry special administration regime (WISAR), the Energy Supply Companies Special Administration Regime (introduced by the Energy Act 2011). This is because SAR legislative frameworks typically adapt general insolvency law to ensure it provides for the specifics of their industry.
- 7.3 The WISAR comes into play when a water industry company becomes insolvent ('an insolvency SAR') or fails to carry out its statutory functions or licensed activities to such an extent that it is inappropriate for the water industry company to hold its appointment or licence ('a performance SAR'). The WISAR is seen as the ultimate enforcement tool in the case of performance SARs, and in both insolvency and performance SARs ensures consumers are protected from the impacts of financial distress and that water and wastewater services will continue to be provided.
- 7.4 The Secretary of State or the regulator, the Water Services Regulation Authority "Ofwat", with the Secretary of State's consent may apply to the High Court for a special administration order, and, if granted, a special administrator is appointed to manage the water industry company. In the case of a water company wholly or mainly in Wales, Welsh Ministers would apply/consent to the application, rather than the Secretary of State. In the case of a qualifying water supply licensee (within the meaning of the WIA) whose licence gives it a supplementary authorisation, the Secretary of State or Ofwat must consult the Welsh Ministers ahead of applying for the special administration order.
- 7.5 While the special administration order is in force, the affairs, business, and property of the water industry company will be managed by a person appointed by the High Court on the proposal of Ofwat or Defra pending either the transfer of the relevant parts of the water industry company's undertaking to another water industry company or companies or the rescue of the water industry company, further detail of which is below.

- 7.6 The Flood and Water Management Act 2010 (Commencement No. 10) Order 2024 commences the rescue and hive down provisions. The rescue provisions will expand the key objectives of a WISAR to include rescue. This will allow otherwise viable water industry companies to enter a special administration, restructure its debts and then exit the SAR as a going concern. Without this, the special administrator can only transfer the regulated business to a new owner and the old water industry company would then exit to liquidation or dissolution. However, rescue provisions are only available for insolvency SARs so if a water industry company enters a performance SAR, its only exit route is via a transfer scheme. Hive-down is a common, commercial restructuring practice to ringfence value and attract potential buyers, as it will enable the administrator to hive-down the regulated business to a subsidiary to benefit from potential tax savings.
- 7.7 There have been significant updates to the Insolvency Act 1986 since it came into force. Most notable updates to the insolvency and restructuring legislative regimes were made by the Enterprise Act 2002, the Small Business, Enterprise and Employment Act 2015, the Corporate Insolvency and Governance Act 2020 and the Insolvency (England and Wales) Rules 2016 (which revoked the Insolvency Rules 1986). A series of legislative updates, including via these Regulations, are now being made to the WISAR to ensure it is aligned with the most up-to-date insolvency and restructuring legislation.
- 7.8 Schedule 5 to the Flood and Water Management Act 2010 introduced special administration-related changes to the WIA. These Regulations are made under powers introduced by that Act and are required in order to implement those changes. The purpose of updating the WISAR legislation is to ensure that, should a water industry company go into special administration, a special administrator is able to administer a modern, efficient WISAR.

Explanations

What was the legislative framework before the changes made by this instrument?

- 7.9 The WISAR legislative framework is set out under sections 23 to 25 of the WIA. Schedule 3 of the WIA is being replaced by Schedule B1 of the Insolvency Act 1986, as modified by these Regulations. This legislative framework sits alongside the Water Industry (Special Administration) Rules 2009/2477 (the 2009 Rules) which are adapted from the Insolvency Rules 1986. However, it should be noted that as part of the WISAR legislative updates, the 2009 Rules will be revoked and will be replaced by updated SAR Rules based on the Insolvency (England and Wales) Rules 2016.

Why is the WISAR being changed?

- 7.10 Given the recent market instability in the energy and banking sectors and the need for HMG intervention in certain instances, e.g., Bulb's special administration, Defra reviewed its powers should a water or sewerage undertaker or qualifying water supply licensee become insolvent or not meet its statutory duties, and the government had to apply for a special administration order. This work flagged that by bringing the WISAR into line with wider developments in the general insolvency and restructuring legislative regimes it could deliver better value for money. As such the Secretary of State Defra is commencing and implementing these provisions to bring it in line with other SAR regimes.

7.11 As outlined in paragraph 2.3, a commencement order will be made to commence paragraph 6 of Schedule 5 to the Flood and Water Management Act 2010 in order to apply Schedule B1 of the Insolvency Act 1986 to the WISAR and replace Schedule 3 to the WIA. The specific modifications to Schedule B1 made by these Regulations are required to apply those provisions to water industry companies undergoing special administration.

What will it now do?

7.12 These Regulations will achieve the below:

- Apply, disapply, modify and make provisions similar to, and in place of insolvency provisions as they apply in relation to water industry companies and special administration orders made in respect of those water industry companies under the WIA. The specific application, disapplication and modification of provisions is detailed below:
 - Make overall provision for applying, disapplying, and modifying provisions of the Insolvency Act 1986 and other enactments about insolvency in relation to special administration.
 - Make general modifications to the Insolvency Act 1986 and other enactments about insolvency (such as insolvency provisions of the Company Directors Disqualification Act 1986) as they apply to special administration.
 - Make specific modifications to Schedule B1 to the Insolvency Act 1986 as it applies in relation to special administration.
 - Make specific modifications to other provisions of the Insolvency Act 1986 as they apply in relation to special administration.
 - Amend 26 of the WIA so it prevents Schedule B1 to the Insolvency Act 1986 from being used to appoint an ordinary administrator in relation to a water industry company.
 - Make specific modifications to Parts 26 and 26A of the Companies Act 2006 as those Parts apply to water industry companies which are in special administration.
 - Amend Schedule 1 to the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013.
 - Make consequential and transitional provision.

The modifications are undertaken with an aim to apply the following principles:

- (a) Only the Secretary of State or Welsh Ministers (the relevant Minister) or Ofwat (with the consent of the relevant Minister) may make an application to the court for a water industry company to go into special administration. Under section 25 WIA, where a court receives a petition for a winding-up order against a water industry company it cannot make a winding-up order against the company and must instead make a special administration order if it is satisfied that it would be appropriate to make a winding-up order if the company were not a water industry company (i.e., if it were an ordinary company);
- (b) In an ordinary administration there is a hierarchy of purposes and the objective that the administrator pursues must be in the interests of creditors as a whole.

The purposes of the WISAR are to ensure the continued provision of essential water and sewerage services and the transfer or rescue of the company; and

- (c) The relevant Minister and Ofwat (whether or not they are the applicant) should have a right to make certain decisions / court applications, receive key information and appear or be represented at hearings, to ensure that the interests of customers are always considered.
- 7.13 The majority of the provisions in Schedule B1 to the Insolvency Act 1986 have an equivalent provision under the former WISAR, but we have also applied (with modifications where necessary) certain provisions in Schedule B1 to the Insolvency Act 1986 to the WISAR which did not have an equivalent under the old regime:
- 7.14 **Paragraph 49:** The special administrator's proposals must explain why the rescue of the company as a going concern (as compared to a transfer of its functions to a buyer) is not likely to be possible; or transfer is likely to secure more effective performance of the functions or activities in section 23(2)(a) or (2A)(a) or (2AA)(a) (where the ground of entry is insolvency). This modification did not appear in the former WISAR because rescue was not available as a statutory purpose. This proposed modification reflects the hierarchy introduced at section 23(2B) of the WIA.
- 7.15 **Paragraph 59:** Any disposal of protected land, or any interest or right in or over that land, must be made with the consent of the relevant Minister or Ofwat. This provides an express reference to the restriction on disposal of protected land which is consistent with the same restriction in section 156 WIA.
- 7.16 **Paragraph 60:** The special administrator has the power to act on behalf of the company for the purpose of any enactment or subordinate legislation which confers a power on the company or imposes a duty on it. In practice, the special administrator has wide powers to act on behalf of the company for anything ancillary to the achievement of the special administration purpose.
- 7.17 **Paragraph 68:** The court may only give directions under para 68(2) which are consistent with the purposes of the special administration order.
- 7.18 **Paragraph 74:** Challenges to the special administrator's conduct may be made by the relevant Minister or Ofwat. Challenges may be made on the following additional grounds:
- (a) the special administrator is conducting the special administration in a way that prevents the achievement of the purpose of the special administration as quickly and efficiently as is reasonably practicable; and
 - (b) the special administrator has exercised or is exercising or is proposing to exercise his powers in relation to the company in a way which involves a contravention of —
 - (i) the conditions of the company's appointment under Chapter 1 of Part 2 of the WIA,
 - (ii) the company's licence granted under Chapter 1A of Part 2 of the WIA, or
 - (iii) any statutory or other requirement imposed on the company in consequence of that appointment or licence.

These grounds for challenge of the special administrator's conduct were included in the former WISAR.

The court may not grant a remedy in respect of a challenge made by creditors or members under paragraph 74 unless the relevant Minister and Ofwat has been given a reasonable opportunity to make representations about the claim and the proposed remedy, relief or order. An order may not be made by the court under this paragraph if it would be likely to prejudice, impede or prevent the achievement of the purposes of the special administration order.

Before making an order for the appointment of the special administrator to cease to have effect, the court must notify the special administrator of (i) the proposed order, and (ii) a reasonable period to make the appropriate response. This provision is included because of the additional rights which the relevant Minister and Ofwat have in respect of making representations and the need for the court to notify the special administrator of an order to terminate his appointment. The relevant Minister and Ofwat's rights are necessary to ensure the special administrator is properly accountable for the achieving the purposes of the special administration order WISAR and their related actions.

- 7.19 **Paragraph 83:** The special administrator may only send a notice to move to a creditors' voluntary liquidation with the consent of the relevant Minister or Ofwat. Under the former WISAR, a creditors' voluntary liquidation was not an expressly available exit option, reflecting the older form of the Insolvency Act 1986 administration upon which it was based. The availability of a creditors' voluntary liquidation as an exit route from the modern form of administration in Schedule B1 mandates the need for this modification.
- 7.20 **Paragraph 84:** The special administrator may only send a notice to move to a dissolution with the consent of the relevant Minister or Ofwat. Under the former WISAR, a dissolution was not an expressly available exit option (reflecting the older form of the Insolvency Act 1986 administration upon which it was based), but is available under Schedule B1, so this modification is needed to reflect the role of the relevant Minister or Ofwat during a water industry company dissolution.
- 7.21 **Paragraph 91:** The relevant Minister or Ofwat may apply to court for the replacement of the special administrator. This is in line with their standing as applicants for the appointment of a special administrator.
- 7.22 **Paragraph 99:** Grants, loans, and repayments in respect of guarantees provided by HMG are made expressly payable (together with other contracts entered into by the special administrator) ahead of the ordinary expenses of the special administration. While any government funding advanced to the company in special administration would have priority expense ranking under para 99(4) (as a contract entered into by the special administrator), this provision is expressly set out in the regime to ensure clarity to creditors and other stakeholders.
- 7.23 **Paragraph 103:** An application to appoint a joint or concurrent special administrator may be made by the relevant Minister or Ofwat. This modification is in line with the relevant Minister or Ofwat's standing to apply for a special administration order.
- 7.24 In addition to the above, these regulations also make specific modifications to Parts 26 and 26A of the Companies Act 2006 as they apply to water industry companies which are in special administration. These procedures are a form of debt restructuring measures and so were not available in the former WISAR, as that did not have rescue provisions. The modifications to Parts 26 and 26A of the Companies Act 2006 as they apply to special administration are as follows:

- Part 26 of the Companies Act introduces a scheme of arrangement (a form of rescue) which is a tool to enable complex debt arrangements to be restructured and to support the injection of new finance. The company will draw up a plan for how the debt should be restructured and creditors will vote on it in separate classes and the plan will require the approval of a majority in number representing a minimum of 75% in value in each class of those present and voting. The Court will grant final approval if just and equitable.
- The Corporate Insolvency and Governance Act inserted Part 26A (Arrangements and Reconstructions for Companies in Financial Difficulties) into the Companies Act 2006 (such arrangements are commonly known as ‘restructuring plans’). Part 26A is modelled on the existing scheme of arrangement procedure in Part 26 but with the addition of the ability to ‘cram down’ across classes of creditors. To propose a restructuring plan, a water industry company must be able to demonstrate that it is encountering or is likely to encounter financial difficulties that affect its ability to continue as a going concern and that approval of the plan would resolve those difficulties. A restructuring plan allows a water industry company to bind dissenting classes of creditors to a restructuring plan, provided at least one class of creditors who would receive a return in the ‘next relevant alternative’ (what would happen absent the restructuring plan) approve the restructuring plan by at least 75% by value of those present and voting. As is the case with Part 26 schemes, the court will always have absolute discretion over whether to sanction a restructuring plan.

7.25 The Regulations amend section 26 of the WIA in order to prevent Schedule B1 to the Insolvency Act 1986 from being used to appoint an out-of-court administrator in relation to a water industry company.

7.26 These Regulations amend Schedule 1 to the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 in order to address a legislative conflict that would otherwise have arisen as a consequence of the transition to the modernised WISAR.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 This is not a consolidating instrument.

10. Consultation outcome

10.1 Although there has been no consultation on this statutory instrument, the changes made to the WISAR by these Regulations are enabled by commencement of provisions of the FWMA (which amend the WIA) and the relevant provisions of the FWMA were subject to a detailed, public consultation in April 2009.

11. Guidance

11.1 No guidance has been produced to accompany this instrument.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities, or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A full Impact Assessment has not been prepared for this instrument because the level of impact for this particular SI is minimal (net present value of the SI over a 10-year evaluation period is likely less than £55,000).

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses such as New Appointments and Variations (NAVVs). NAVVs are limited companies which provide a water and/or sewerage service to customers in an area which was previously provided by the incumbent monopoly provider. As NAVVs supply water and/or sewerage services to customers in the same way as water and sewerage companies, the amendments made by this Regulations apply to them to ensure continuous service to customers should one enter into a WISAR.

14. Monitoring & review

- 14.1 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, Robbie Moore MP, Parliamentary Under Secretary of State for Defra has made the following statement:

“The inclusion of a review provision for the purposes of s.28(2)(a) of the Small Business, Enterprise and Employment Act 2015 is not considered appropriate for these Regulations, hence this statement is made in accordance with s.28(2)(b) of that Act. Having had regard to the guidance promulgated under s.31(4) of that Act, the inclusion of a review provision in these Regulations is considered disproportionate taking into account the economic impact the Regulations are likely to have on any qualifying activity since its use is expected to be infrequent. However, a non-statutory monitoring and evaluation plan has been developed for these Regulations.”

15. Contact

- 15.1 Atikah Moosa at the Department for Environment, Food and Rural Affairs: email (Atikah.moosa@defra.gov.uk), can be contacted with any queries regarding the instrument.
- 15.2 Kiana Salamian at the Department for Environment, Food and Rural Affairs: email (Kiana.Salamian1@defra.gov.uk), can be contacted with any queries regarding the instrument.
- 15.3 Davide Minotti, Deputy Director for Water Services, at the Department for Environment, Food and Rural Affairs can confirm that this Explanatory Memorandum meets the required standard.
- 15.4 Robbie Moore MP, Parliamentary Under Secretary of State for Defra can confirm that this Explanatory Memorandum meets the required standard.