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New UK Legislation to Facilitate Special Administration of Water Companies

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At a Glance

The UK government has introduced a suite of new or draft statutory instruments to facilitate special administration of regulated water companies.

The new/draft legislation adjusts the existing special administration regime for water companies by:

- a) **Hive-down**: making effective provisions governing hive-down transfer schemes – this means that, hypothetically, special administrators of a regulated water company could transfer its entire undertaking to a wholly owned subsidiary and then sell its shares in that subsidiary, potentially “stranding” debt issued higher up the corporate group;
- b) **Rescue purpose**: making effective provisions governing an additional “rescue” purpose, where the special administration is commenced on the basis that the company is or is likely to be unable to pay its debts;
- c) **Application/modification of standard insolvency legislation**: applying the latest restructuring and insolvency legislation to water company special administration, with certain modifications, including modified versions of the standard administration, restructuring plan, scheme of arrangement and company voluntary arrangement proceedings; and
- d) **New Insolvency Rules**: indicating plans to introduce updated Insolvency Rules for water company special administration.

Together, these changes reflect the government's detailed practical preparations and contingency planning for the possibility that the water special administration regime may soon be used in practice for the first time.

Brief Background: Existing Special Administration Regime

Ofwat or the Secretary of State may apply to the High Court for commencement of special administration of a regulated water company, including on the grounds that (a) the company is or is likely to be unable to pay its debts (the 'insolvency ground') and/or (b) there has been, is or is likely to be a contravention by the company of any condition of its licence which is "serious enough to make it inappropriate for the company to continue to hold its appointment" (the 'performance ground' – which does not apply in special administration regimes in other sectors).

During special administration, the affairs, business and property of the company would be managed by the court-appointed special administrators, "in a manner which protects the respective interests of the company's members and creditors".

Latest Refinements

The new legislation comprises [The Flood and Water Management Act 2010 \(Commencement No. 10\) Order 2024](#), effective 12 January 2024, and two draft statutory instruments, [The Water Industry Act 1991 \(Amendment\) Order 2024](#) and [The Water Industry \(Special Administration\) Regulations 2024](#) (which are not yet effective). Together, these instruments would effect the following refinements to the existing water company special administration regime.

- **Transfer by Hive-Down:** On special administration of a regulated water company, transfer as a going concern of the company may be effected by "hive-down", by:
 - a) transferring all or part of the company's undertaking to a wholly owned subsidiary of the company, and
 - b) then transferring securities in the subsidiary to another company.

Under the previous legislation, only a direct sale of assets would be possible. The new hive-down structure is intended to maximise value on sale (by ringfencing value and

enabling potential tax savings, thereby attracting buyers); it is also in line with other special administration regimes in other sectors.

- **Additional “Rescue” Purpose:** If the special administration is commenced on the basis of the insolvency ground, i.e., that the company is or is likely to be unable to pay its debts, then:

a) a purpose of the special administration order is to rescue the company as a going concern; and

b) if the special administrators think it is likely to be possible to rescue the company as a going concern, they are to pursue that purpose (by proposing a company voluntary arrangement, scheme of arrangement or restructuring plan) – unless they think a more immediate transfer is likely to secure more effective performance of the company’s formal functions.

This allows otherwise-viable water companies to enter special administration, restructure their debts and then exit special administration as a going concern. (Before these changes, special administrators could only transfer the regulated business to a new owner and the old water company would then exit to liquidation or dissolution.)

Notably, the rescue purpose only applies where the special administration was based on the insolvency ground; if it commences on the performance ground, the only exit route is through transfer (whether by hive-down or otherwise).

- **Application (and Modification) of Latest Insolvency Legislation to Water Company Special Administration:**

a) A **modified version of the standard administration regime** (namely, Schedule B1 of the Insolvency Act 1986) will be applied to water companies in special administration. Modifications include, for example, who may appoint an administrator and the statutory purpose of the administration, which are necessarily different in the context of a water company special administration. Further (and non-exhaustively):

- to minimise potential losses for the State and its taxpayers, **priority right of repayment** is granted in respect of (i) grants, (ii) loans or (iii) sums payable in respect of indemnities that (in each case) were made or given within the special administration by the Secretary of

State; such claims will rank ahead of the special administrators' own remuneration and expenses;

- special administrators' ability to dispose of **property subject to a fixed charge** (with the court's permission), as if it were not subject to the security, is subject to a modified safeguard such that:
 - if the court enables the special administrators to dispose of the secured property (which requires the court to think that disposal would be likely to promote the purpose of the special administration); then
 - a condition of the court's order will be that the following are applied to discharge amounts secured by the fixed charge: (X) the net proceeds of disposal of the property and (Y) any additional money required to be added to the net proceeds so as to reflect the amount that would be realised on a sale at "appropriate value", which means "the best price that could be reasonably available on a sale which is consistent with the achievement of the purposes of the special administration";
 - in contrast, the equivalent safeguard in the context of ordinary administration applies a "market value" safeguard, which means "the amount which would be realised on a sale of the property in the open market by a willing vendor"; and
 - accordingly, this modification envisages the possibility that a sale of assets secured by a fixed charge could (with court permission) occur without the charge-holder receiving "market value" and instead receiving only the best price reasonably available consistent with achieving the purpose of the special administration¹;
- there is **no requirement** for special administrators of a water company to seek a **decision from its creditors** on the administrators' proposals;
- there are **restrictions on disposing of "protected land"** without the regulator's consent; and
- a **creditor- or shareholder-led challenge to special administrators' conduct** must be predicated on a claim that "the special administrator is conducting the special administration in a way that is preventing its purposes from being achieved as quickly and efficiently as is reasonably practicable" (creating a higher bar than the applicable basis in standard administration, which is that

“the administrator is not performing his functions as quickly or as efficiently as is reasonably practicable”)²; additional hurdles also apply to such challenges, e.g., the court may not grant relief if it would be likely to prejudice the achievement of the purposes of the special administration and must give the special administrators opportunity to “course-correct”, by remedying their conduct before the court considers making a final order against them.

b) **Other provisions** of the Insolvency Act 1986 and the Companies Act 2006 will also apply in water company special administrations, including:

- **schemes of arrangement and restructuring plans**, with modifications including that only the special administrator may apply for convening and sanction orders;
 - **company voluntary arrangements** (with minor modifications); and
 - **vulnerable antecedent transactions**, e.g., transfers at an undervalue and preferences; fraudulent and wrongful trading.
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- **Updated Insolvency Rules** for water company special administration will soon be introduced.³ The draft legislation⁴ includes specific provision to facilitate this, with new Rules to be made by the Lord Chancellor with the Secretary of State’s agreement without the need for a positive vote by Parliament (though subject to annulment in the event that Parliament votes to overturn it). There is a convention that such statutory instruments should not come into effect until at least 21 days after they have been formally presented to Parliament.

We are happy to discuss further with interested clients.

1. Whether that be the rescue purpose (if the special administration is commenced on the insolvency ground) or transfer of the company’s functions (if the special administration is commenced on either the insolvency ground or the performance ground). ↩

2. “Unfair harm” provides an additional ground of challenge, in both water company special administration and standard administration. ↩

3. Paragraph 7.9 of the [explanatory memorandum](#) to The Water Industry (Special Administration) Regulations 2024. ↩

4. Regulation 49 of The Water Industry (Special Administration) Regulations 2024. ↩

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Suggested Reading

- 16 January 2024 Award Outstanding Restructuring Lawyer 2023
- 08 January 2024 Kirkland Alert Trends and Developments in the German Restructuring Market
- 14 December 2023 Award #1 Restructuring Firm - Global Restructuring Review

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