

Insights

RECENT CHANGES TO THE SPECIAL ADMINISTRATION REGIME FOR WATER COMPANIES

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SUMMARY

The UK government recently introduced legislation implementing changes to the special administration regime for regulated water companies (“WISAR”). The changes are designed to modernise the WISAR and to better align it with the special administration regimes for other systemically important sectors like energy supplies and investment banks.

The updates are contained in The Flood and Water Management Act 2010 (Commencement No. 10) Order 2024, which became effective on 12 January 2024, and The Water Industry Act 1991 (Amendment) Order 2024 and The Water Industry (Special Administration) Regulations 2024, each of which came into effect on 22 February 2024.

The most notable changes to the WISAR are as follows:

RESCUE PURPOSE

Where a company enters special administration on the grounds that it is, or is likely to be, unable to pay its debts (i.e. on “insolvency grounds”), the primary purpose of that special administration is the rescue of the company as a going concern. Previously, the purpose of the administration was the transfer of the water company’s undertakings to a new entity. The rescue purpose does not apply to a water company which enters special administration on ‘performance grounds’ (i.e. where there has been a contravention by the company which “is serious enough to make it inappropriate for the company to continue to hold its licence”).

NEW POWERS

A special administrator of a company that has entered special administration on insolvency grounds can now implement modified versions of certain restructuring tools (such as the CVA or Part 26 scheme of arrangement), which will assist in facilitating the rescue of a company as a going concern. Prior to these changes, the special administrator only had the power to transfer a

water company's undertakings to a new entity (which meant that, in practice, there was no procedure through which a company could be rescued as a going concern).

NEW HIVE-DOWN POWERS

The special administrator now also has the power to effect a sale of a company's business and assets (including liabilities) by way of a "hive-down", which would involve a transfer of certain or all of a company's business and assets to a newly incorporated subsidiary, and a subsequent sale of the shares in that subsidiary to a new purchaser. This may provide potential tax benefits to the purchaser.

TRANSFER OF BUSINESS NO LONGER PRIMARY FOCUS

The special administrator may only rely on the 'transfer purpose' if it forms the view that (a) it is not likely to be possible to rescue the company as a going concern or (b) the transfer of the company's assets is likely to secure more effective performance of the company's functions or activities. As noted above, the special administrator's powers were previously limited to transferring the company's undertakings to another entity. Furthermore, if the special administrator forms either of the views referred to in (a) or (b) above, it must explain why in its proposals to creditors.

MODIFIED APPLICATION OF SCHEDULE B1

Schedule B1 to the Insolvency Act 1986 now applies to the WISAR, subject to certain modifications including:

- A special administrator must obtain the consent of the Secretary of State before disposing of a company's "protected land". The Secretary of State can provide its consent subject to any conditions it considers appropriate. In practice, this means that any sale of the company's business will require the support of the Secretary of State.
- A special administrator may dispose of property subject to a fixed charge with the court's permission for "appropriate value", which is defined as "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 a standard administration, the fixed charge holder is entitled to receive the "market value" for those assets. The "appropriate value" may be less than the "market value", which may be disadvantageous from the perspective of a secured lender.
- The grounds upon which a special administrator's conduct can be challenged by a creditor or member are narrower than in a standard administration, in that such a challenge can only be made on the basis 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" (compared with a standard administration, where a complaint may be

made on the basis that the administrator is “not performing his functions as quickly or as efficiently as is reasonably practicable”).

- The special administrator is not required to seek and/or obtain creditor approval of its proposals, unlike in a standard administration.
- A special administrator may only ask the court to make an order ending the special administration on the basis that the purpose of the special administration has been achieved. In a standard administration, the administrator can ask the court to make such an order if (i) it thinks that the purpose of the administration cannot be achieved; (ii) it thinks that the company should not have entered administration; or (iii) the company’s creditors decide such an order should be made.
- A special administrator can only move to a creditors’ voluntary liquidation or dissolution of the company with the consent of the Secretary of State or Ofwat.
- Any grants, loans or indemnities provided by the Secretary of State during the special administration will be repayable in priority to and ahead of the special administrators’ fees and expenses.

AVAILABILITY OF MODIFIED RESTRUCTURING TOOLS

Modified versions of the Part 26 Scheme of Arrangement and Part 26A Restructuring Plan are now available to water companies in special administration. The modifications primarily provide that an application under Part 26 or Part 26A may only be made by a special administrator (usually such applications can be made by the company, a creditor or any liquidator or administrator of the company) and that notice of any such application must be given to the Secretary of State and Ofwat. In addition, a modified version of the CVA is now available to companies in special administration.

NEW INSOLVENCY RULES

The government has also foreshadowed that it will be revoking and replacing the existing insolvency rules for special administrations, which are based on the now-outdated Insolvency Rules 1986, with new rules based on the Insolvency Rules 2016. It is not yet clear when such new rules will be introduced.

If you are interested in discussing these changes in further detail, please do not hesitate to contact a member of our Restructuring and Insolvency team.

RELATED PRACTICE AREAS

- Regulation, Compliance & Advisory
- Restructuring & Insolvency/Special Situations

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