EXPLANATORY MEMORANDUM TO

THE WATER INDUSTRY ACT 1991 (AMENDMENT) ORDER 2024

2024 No. XXXX

1. Introduction

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

2. Purpose of the instrument

2.1 This statutory instrument provides that on special administration of a water industry company (which means a company of a kind mentioned in section 23(1) of the Water Industry Act 1991 ("WIA")), transfer of the water industry company may be effected by way of transfer of all or part of the water industry company's undertaking to a wholly-owned subsidiary of the water industry company followed by transfer of securities in the subsidiary to another company (i.e. new owner(s)), known as "transfer by hive-down".

2.2 This Order does this by amending Schedule 2 to the WIA in consequence of section 23(2H) of that Act. Section 23(2H) was inserted by the Flood and Water Management Act 2010 (c. 29) ("FWMA") (paragraph 5(1) of Schedule 5) and commenced by the Flood and Water Management Act 2010 (Commencement No. 10) Order 2024.

2.3 Schedule 2 of the WIA makes provision about transfer schemes upon the termination of an appointment or transfer of a licence of a water industry company, and is amended by this Order to include provisions about transfer schemes in cases where there is a transfer by hive-down. This is necessary to ensure the hive-down provisions in section 23(2H) of the WIA are fully operable.

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 Minister 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 Act 1991 (Amendment) Order 2024 are compatible with the Convention rights."

6. Legislative Context

6.1 The Secretary of State makes this Order with the consent of the Welsh Ministers and in exercise of the powers conferred by the FWMA.

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 performance and insolvency 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 company wholly or mainly in Wales, Welsh Ministers would apply/provide the relevant consent, 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 the Defra Secretary of State 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.

7.6 The Flood and Water Management Act 2010 (Commencement No. 10) Order 2024 also commences the rescue 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 SAR for performance reasons, its only exit route is through the transfer scheme.

7.7 There have been significant updates to the Insolvency Act 1986, upon which the WISAR is based since its entry 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 this Order, 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 FWMA introduced significant special administration-related changes to the WIA, amongst which are the hive-down provisions (paragraph 5(1)). 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. Hive downs are also a factor of other SARs, and as such hive-down provisions were included within the FWMA, in the form of amendments to be made to the WIA, however, they have simply not been brought into force to date.

7.9 The Flood and Water Management Act 2010 (Commencement No. 10) Order 2024 commences the hive-down provisions, amongst other things, and this Order is needed in consequence to that to make amendments to Schedule 2 WIA to ensure the hive-down provisions are fully operable. The purpose of doing this is to ensure the special administrator can pursue the best value for money transfer option at the end of a SAR.

Explanations

Why is it 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 commencing hive-down provisions would deliver better value for money in the event of a post-SAR sale of a water industry company. As such the Defra Secretary of State is commencing and implementing these provisions to bring it in line with other SAR regimes and ensure the WISAR can deliver value for money.

What will it now do?

7.11 As noted in paragraphs 2.1-2.2, this instrument amends Schedule 2 to the WIA in consequence of section 23(2H) of that Act. Section 23(2H) was inserted by the FWMA (c. 29) (paragraph 5(1) of Schedule 5) and commenced by the Flood and Water Management Act 2010 (Commencement No. 10) Order 2024. It provides that on special administration of a water industry company, transfer of the water industry company may be effected by way of transfer of all or part of the water industry company's undertaking to a wholly-owned subsidiary of the water industry company followed by transfer of securities in the subsidiary to another water industry company (known as "transfer by hive-down").

7.12 This Order amends Schedule 2 WIA, which makes provisions about transfer schemes upon the termination of an appointment or transfer of a licence of a water industry company, to include provisions about transfer schemes in cases where there is a transfer by hive-down. This is necessary to ensure the hive-down provisions in section 23(2H) WIA are fully operable.

7.13 As noted in paragraph 7.8, hive-down provisions, a feature of other SAR regimes, will enable the special administrator to hive-down or transfer the whole or part of a regulated business to a wholly owned subsidiary of the failing water industry company in advance of the transfer of the securities in that subsidiary to one or more new owners. The primary benefits of this, include making a sale following a SAR better value for money which is in line with existing SAR regimes in other sectors. This is because any assets that are capital assets or intangible fixed assets should benefit from 'no gain, no loss' treatment on transfer on the hive-down, thus removing the corporation tax liability. Additionally, no balancing charges should arise on the transfer of assets in respect of which a water industry company has claimed capital allowances.

7.14 In addition, hive-down benefits the new owners as it could allow them to acquire a "clean" water industry company which does not come with existing liabilities (which remain with the original owners), so there would be less of a risk of unforeseen liabilities coming along later. Removing liabilities and the need to take on surplus assets that cannot be sold separately as well as removing tax liabilities associated with the sale could help maximise value in the water industry company, so could provide more funds for the special administrator to repay creditors than would have been available if hive-down was not permitted. This may also benefit customers who might not have to incur potential bill increases for unforeseen liabilities associated with the previous owner.

7.15 Conversely, under the current legislative framework, only a direct sale of assets (as opposed to a hive-down) would be possible. This is likely to be costlier and more complex to implement for the new owners, as they wouldn't be able to benefit from the corporation tax savings as explained above, and there is the risk of future unforeseen liabilities. Therefore, a post-SAR sale under the current WISAR would not be as attractive to investors and so might not be at made at an appropriate value.

8. European Union Withdrawal and Future Relationship

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

9. Consolidation

9.1 This instrument amends Schedule 2 of the WIA consequential to amendments introduced by the FWMA (as opposed to amending secondary legislation). The question of consolidation therefore does not arise.

10. Consultation Outcome

10.1 There has been no consultation as this Order makes limited technical changes consequential to the commencement of an amendment to the Water Industry Act 1991 made by the FWMA. However, the relevant hive-down 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 significant, direct impact on business, charities or voluntary bodies. Familiarisation costs are not expected to surface, due to special administrators already being familiar with the hive-down provisions present in other industries. The only additional cost administrators are estimated to face through the use of hive-down provisions at the end of a SAR is the cost of registering online or by paper a water industry company incorporation for creating the wholly owned subsidiary and separating the business for transfer into the subsidiary on Companies House. This is estimated to cost between £10 and £40 and therefore falls far below the £5m annual de minimis threshold.

12.2 There is 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 (NAVs). NAVs 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 NAVs supply water and/or sewerage services to customers in the same way as water and sewerage companies, the amendments made by this Order 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:

"A statutory review clause has not been included in this instrument because it does not make or amend any regulatory provision; this instrument makes consequential amendments to Schedule 2 of the Water Industry Act 1991 occasioned by the introduction of the hive-down provision (section 23(2H))."

15. Contact

15.1 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.

15.2 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.

15.3 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.