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Insights

UNIVERSITY INSOLVENCY

Why existing restructuring tools are not enough

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Summary

In **Part 1, *What Happens If a UK University Fails?,*** Richard Obank explored the growing financial pressures facing the higher education sector and the limitations of the existing insolvency framework available to universities.

In this second instalment, the legal analysis continues by considering the practical options available to a financially distressed Royal Charter institution, including receivers and managers and a scheme of arrangement. It then turns to the further education regime and asks whether that framework provides a workable blueprint for higher education, while recognising the additional challenges created by degree awarding powers, funding, charitable assets, research infrastructure and scale.

The options for a RCI in acute financial distress appear to be confined, practically, to engaging with the OfS and pursuing a negotiated merger or asset transfer on a solvent basis; alternatively, seeking to invoke the court's inherent jurisdiction over charitable corporations or, as a last resort, engaging with the Privy Council on charter surrender. Or (most likely) by applying to court for a compulsory winding up order (and appointment of special managers) as an unregistered company.

Rectifying these anomalies in an insolvency context requires secondary legislation under section 249 Enterprise Act 2002 (or the introduction of a SAR which Government has just ruled out).

Appoint receivers and managers

The unavailability of Schedule B1 of the IA1986 does not mean there are no judicial options available in respect of a financially distressed RCI. For example, the High Court has an ancient and broad inherent jurisdiction over charitable corporations, supplemented by the Charities Act 2011. This could enable the High Court to appoint receivers and managers over the property of a charitable corporation for the protection of the charitable estate. Once appointed, they could seek court powers to carry on trading the operation of the university to avoid a disorderly exit.

Similarly, the Charity Commission has powers to appoint a receiver and manager in specific circumstances in order to protect charitable property.

Scheme of arrangement

It might be possible for a RCI in financial distress to surrender its charter to the Privy Council and seek approval for a scheme of arrangement involving the transfer of assets to a successor charitable body. This would be incredibly complex to implement assuming there was sufficient time and funding to do so. And it would be carried out in the full glare of public and political scrutiny through the courts.

Further education institutions (‘FEIs’): an uncomfortable comparison?

Why do FEIs have a safety net on insolvency when HEIs do not? That is the question that ought to trouble policymakers notwithstanding the recent announcement by Government rejecting calls for a SAR for HEIs.

FEIs have a regime introduced by the TFEA 2017.[1] The regime for FEIs came into force on 31 January 2019. Essentially, it was recognised that the standard insolvency framework of administration and liquidation was inadequate for bodies providing publicly funded education and training to young people and vulnerable adults and that a SAR was needed to protect learners and the public interest.

The regime recognises that when a FEI providing vocational education and training fails, the public interest requires a bespoke solution. The main objective is to avoid or minimise disruption to the studies of existing students as a whole (section 16(1) of the TFEA 2017). The means by which this may be achieved include:

- rescuing the FEI as a going concern;
- transferring some or all of its undertaking to another body;
- keeping it going until existing students have completed their studies; or
- making arrangements for existing students to complete their studies at another institution (section 16(2) of the TFEA 2017).

Bodies covered

The FEI SAR regime covers a range of bodies:

- Further education corporations established under the FHEA 1992.
- Sixth form college corporations.
- Designated institutions under the FHEA.
- Independent learning providers registered with the ESFA.

The common thread is these bodies provide publicly funded education within the ESFA's regulatory and funding remit.

Key features

The regime for FEIs is a Schedule B1 administration procedure with special features:

- **Learner protection**: the primary objective is to avoid or minimise disruption to the studies of students and, where that is not possible, to ensure that existing studies of students are protected as well as is reasonably practicable. Only after pursuing this primary objective is there a requirement to pursue the ordinary statutory objectives of administration.
- **Secretary of State involvement**: the Secretary of State can apply to court for the appointment of a special administrator. Accordingly, Government has a direct role in initiating insolvency proceedings. There is a graduated escalation pathway (involving monitored visits and formal interventions) before that point.
- **Transfer mechanisms**: there are powers to facilitate the transfer of property, rights, and liabilities to successor providers, making it easier to facilitate teaching provision elsewhere.[2]
- **Regulatory coherence**: the regime was designed to work alongside regulatory and funding infrastructure for FEIs, including the provision of short term cash support to facilitate an orderly transfer to a successor body. The transfer scheme operates as a statutory novation whereby contractual and funding arrangements can be transferred to a successor without consents. This is a powerful tool with no direct equivalent in an ordinary administration under Schedule B1 of the IA 1986. The ability of the Secretary of State to underwrite the costs of the process is a genuine learner protection mechanism.[3]

A blueprint for HEIs?

This regime is a well-designed piece of sectoral insolvency legislation. It works because it is tailored to the sector's regulatory, funding and constitutional characteristics. However, whilst instructive, it cannot simply be transplanted from FEIs to HEIs for several reasons:

- **DAPs:** the power to award degrees is a statutory privilege granted under the Higher Education and Research Act 2017 ('**HERA 2017**') (or under legacy arrangements for established universities). These powers, which are personal to the institution, cannot be transferred by a special administrator. A specific mechanism would be needed either for temporary continuation of DAPs or an expedited process by which a successor body could exercise DAPs on behalf of the failing body.

- **Funding:** funds from the SLC flow only to OfS-registered providers. If OfS registration is at risk, funding could be suspended. In contrast, ESFA funding for a FEI can be redirected relatively quickly. OfS registration is not easily transferable meaning a special administrator would be operating without cashflow certainty.

- **Corporate structures:** FEIs are predominantly statutory corporations with broadly similar structures. HEIs have a range of structures with different constitutional rules and relationships with insolvency law. Legislation would be required to ensure that all constitutional formats are covered.

- **Charitable constraints:** many HEIs hold permanent endowments and restricted funds accumulated over decades or even centuries. These funds are unavailable to creditors or for general trading activities. Any special administrator would need to navigate their way through these constraints in accordance with charity law, ensuring that endowment income is applied for the correct purposes.

- **Research infrastructure:** HEIs are embedded in the national research system in a way that FEIs are not. Grants, projects and research partnerships create webs of obligation that a special administrator would need to manage and enable a successor body to inherit.

- **Scale**: a failure of a major university would be on a completely different level of magnitude compared to a college failure. The failure of a college, whilst serious for its learners, is predominantly a localised event whereas the failure of a major university would have systemic implications.

These additional layers would need a materially more sophisticated legislative instrument for HEIs. But is this complexity truly a reason to avoid the issue altogether given the inevitable chaos that would follow a university failure? Or is it a reason to approach the task with appropriate care and, critically, do so before a financial crisis arises within one of our major universities?

BCLP's Restructuring & Insolvency practice advises universities, colleges, lenders, investors, governing bodies and other stakeholders on financial distress, restructuring, mergers, governance, contingency planning and complex stakeholder situations. Drawing on expertise across restructuring, higher education, charity law, employment, real estate and regulation, our multidisciplinary team helps clients navigate periods of change and uncertainty. To discuss any of the issues raised in this series, please contact ***Richard Obank*** *or your usual BCLP contact.*

Coming next

Part 3 weighs the policy arguments for and against a special administration regime and examines whether the NHS special measures and energy supplier-of-last-resort models offer a more practical route to reform.

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[1] Chapter 4 of Part 2 of the TFEA 2017, commencing at section 15. The procedure created is known as 'education administration'.

[2] Under section 14B FHEA, the Secretary of State (being the appropriate national authority) may apply to court for the appointment of a special administrator where the FEI body is unable, or likely to become unable, to pay its debts, and the Secretary of State considers it is in the public interest for a special administrator to be appointed. This gives Government a direct role in initiating insolvency proceedings.

[3] Section 27 of the TFEA 2017: grants or loans to the FEI for the purpose of achieving the objective of the education administration can be made on whatever terms the Secretary of State considers appropriate, including repayment with or without interest.

Related capabilities

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