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**Insights**

# SPECIAL ADMINISTRATION, SPECIAL MEASURES OR A UNIVERSITY "SUPPLIER OF LAST RESORT"?

The policy choices for protecting students and managing failure

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## Summary


In Part 1, *What Happens If a UK University Fails?*, Richard Obank explored why mounting financial pressures mean university failure can no longer be dismissed as a theoretical risk. In Part 2, *University Insolvency: Why Existing Restructuring Tools Are Not Enough*, he examined the gaps in the current legal framework and considered whether the further education sector offers a potential model for reform.

The final instalment considers the case for and against a special administration regime for higher education institutions. It then looks beyond conventional insolvency law to the graduated intervention model used in the NHS and the supplier-of-last-resort mechanism used in the energy sector, before setting out the case for an early-warning framework, regulatory intervention and a credible last-resort process.


## The case 'for' an HEI SAR

At first blush, the arguments for a HEI SAR appear compelling:

- **Public interest:** students enrolled at a failing university are not ordinary unsecured trade creditors and should not be treated as such. They are young persons who have taken on significant debt to obtain a degree qualification. Treating those interests as incidental to a formal insolvency process cannot be justified on public policy grounds.
- **Regulatory coherence:** giving the OfS a formal role in the management of a failing university is preferable to decision-making to an insolvency practitioner with no statutory obligation to prioritise learner protection.

- **Funding continuity:** a new framework could be designed to maintain OfS registration and income flows to create a runway for an orderly restructuring process.
- **Transfer mechanism:** a statutory transfer mechanism to a successor body would protect teaching provision and protect student outcomes.
- **Mitigate contagion:** the unplanned insolvency of a major university would not be a self-contained event. A bespoke regime would significantly reduce the wider political, communal and economic damage arising from a disorderly exit.
- **Alignment:** other regulated sectors providing essential public services have special regimes. Parliament is more than capable of legislating in the HEI space where there is a political will to do so.
- **Loan markets:** the current uncertainty about what might happen following a university insolvency operates as a constraint on the availability and pricing of debt finance. A clear and predictable regime for HEIs is likely to make it easier and cheaper to access the loan markets to avert a financial crisis.
- **No disorderly exit**: this is the strongest argument in favour of a special regime for HEIs. Put simply, an unplanned liquidation of a major university would be a catastrophe for students, staff, the local community and the wider economy. It would also significantly damage the UK's leading reputation for higher education and attracting overseas students.

## The case 'against' a HEI SAR

Arguments against are not simply about institutional inertia and complexity. There are genuine policy concerns to address:

- **Moral hazard:** if a statutory 'safety net' exists for HEIs, whereby regulators will intervene to fund an orderly exit, would that encourage the appointment of administrators at an earlier stage in the lifecycle and increase failure risk? The availability of a special regime could reduce management incentive to avoid a formal insolvency because there is a statutory default option which would facilitate 'easy' access to Government funding.
- **Negative optics:** the appointment of a special administrator to a major university would be an event of enormous public and political sensitivity. Any Secretary of State approving such an appointment would face immediate personal and, potentially, career-ending criticism.
- **Lowering the threshold for a bailout:** a special regime would force a bailout by Government masquerading as regulatory intervention. There may be a strong political preference for the current uncertainties compared to a statutory obligation to intervene and fund.

- **Structural diversity:** drafting a special regime that works for every type of HEI would be a genuinely difficult legislative task.

- **The OfS already has significant powers:** through its conditions of registration and financial monitoring, the OfS already has intervention tools at its disposal. For example, student protection plans require registered providers to have arrangements in place to protect students in a market exit.[1]

If a special regime for HEIs is not to be implemented by Government, as is the case for the foreseeable future, what other options might be made available for failing universities, if there is political will to make them available?

## The NHS special measures model: lessons worth learning?

The special measures model in the health sector is built on early warning systems and a 'protocol' for managing the risk of insolvency which has several key attractions. Indeed, the need for 'an early warning system' to highlight when a university is in danger was flagged in the Education Committee's report.[2]

Currently, there is no protocol for responding to a situation where a university is at risk of financial collapse. A protocol could, for example, address when regulators should intervene. This would enable an 'at risk' university to make informed decisions on a range of options to protect students, staff and the wider community.

Under the framework developed by Monitor (now NHS England/NHS Improvement), NHS Foundation Trusts that are financially or clinically failing can be placed into a graduated special measures regime. Under the licensing regime established by the Health and Social Care Act 2012, NHS England can impose discretionary requirements when a Foundation Trust breaches its licence conditions. These include monetary penalties and compliance requirements to prevent breach continuation. NHS England can also accept enforcement undertakings from trusts to take remedial action. This is not formal insolvency; it is regulatory intervention which averts formal insolvency. Its key features are:

- **Escalating oversight**: the trust is subjected to enhanced regulatory scrutiny with regular reporting and inspections.

- **Improvement directors**: NHS Improvement can appoint directors to work alongside (not replace) the existing board.

- **Support and challenge**: the regime is explicitly supportive not just supervisory: the aim is recovery, not punishment.

- **Transaction facilitation**: where a merger or acquisition is the right answer, NHS Improvement can facilitate and support the transaction, including bridging support and managing the regulatory aspects of a transfer.

Where special measures do not work, a trust special administrator can be appointed under the NHS Act 2006. However, this is genuinely a last resort precisely because the graduated intervention regime is designed to identify and solve problems at an earlier stage.

## Could HEIs benefit from a similar model?

The NHS model suggests that a graduated intervention regime, alongside an early warning system, with the OfS playing a central role analogous to NHS Improvement, might have a lot of attraction. For example, this could be designed to involve:

- Graduated 'intensive support' designations for failing to meet defined financial criteria which trigger OfS intervention leading to the appointment of improvement managers working alongside existing management.
- A 'transaction facilitation' role for the OfS in merger processes, including the ability to provide regulatory comfort as part of any restructuring  (e.g. by maintaining registration conditions during a transfer period).
- Expedited registration and DAP assessment processes for successor bodies in OfS-supported transactions.
- A clear statutory last resort option of  special administration which would only be available where graduated intervention has failed, with the priority objective of 'protecting students' and achieving an orderly transfer rather than simply maximizing creditor returns.

Graduated support of this nature could address many of the moral hazard objections to a standalone special regime by ensuring that formal insolvency becomes available only at the end of a process of escalating intervention, not a sudden event with no time to plan for an orderly exit. It could also give the OfS a defined role at each stage of the process.

## What about the SOLR Model for energy companies?

The energy sector's special administration framework, and related supplier of last resort mechanism ('**SOLR**') operated by Ofgem, represents one of the most developed and operationally tested examples of a sector specific insolvency regime designed to protect end users of an essential service from the effects of provider failure. Does this provide a useful template?

The framework for energy supply companies operates on two tiers:

 

- the SOLR mechanism: this is a pre-insolvency tool by which Ofgem directs a solvent licensed supplier to take on the domestic and small business customers of a failed supplier, without any formal insolvency appointment; and
- the special administration regime under the Energy Act 2011: this is a formal insolvency procedure applicable to licensed energy suppliers where the SOLR mechanism is unavailable or inadequate.

The central concept is the 'protected supply objective' which requires the special administrator to keep the company's transmission or distribution systems, or the company's transporter pipeline system or gas processing facility, in operation (in the case of network companies) or (in the case of supply companies) to ensure that customers continue to receive gas and electricity supply throughout the special administration period.

Ofgem plays a central role:

- It can apply to court for the appointment of a special administrator alongside the Secretary of State.
- It maintains regulatory oversight of the special administrator and can impose licence conditions.
- It is actively involved in the SOLR process.
- It has information gathering and monitoring powers.

The Energy Act 2011 expressly provides for the Secretary of State to provide financial assistance to a company in energy special administration. The regime includes statutory powers to effect the transfer of supply contracts, customer accounts and associated assets to a successor licensed supplier, without requiring consents.

Ofgem is not merely an interested observer but it has standing to apply for the appointment of a special administrator, has powers to supervise the administrator and an ability to modify regulatory conditions during the process. When an energy supplier fails:

- Ofgem identifies the failure and designates a SOLR willing to take on the failed supplier's customer book.
- The SOLR takes on customers automatically, without their individual consent, on standard terms.
- Ofgem operates a levy by which the costs incurred by the SOLR in taking on stranded customers are socialised across the sector and ultimately recovered through energy bills.

The SOLR mechanism has been used many times to protect domestic energy customers. It is quick, administratively manageable and does not require a formal insolvency appointment.

## The SOLR Model applied to HEIs

The SOLR mechanism offers a template for what might be termed a 'student transfer of last resort' option.

Where a university faces financial failure, the OfS could be empowered to identify a successor body and facilitate the orderly transfer of students to that body before a formal insolvency appointment is unavoidable. The successor body would take on students with their academic credits preserved and student loans continuing to be disbursed. The costs incurred by the successor body in absorbing the new students could be met through a national levy mechanism (which would also have a deterrent effect). This mechanism could be implemented swiftly whilst avoiding the consequences of administration or liquidation.

Of course, issues remain to be solved in relation to DAPs, student 'happiness' in being transferred to a successor body, charitable and endowment constraints, preservation of research infrastructure  and international partnerships. None of these arise in the energy context.

However, the SOLR mechanism has much to commend it in the context of regulatory licence continuity, use of a pre-insolvency transfer mechanism, socialisation of costs via a levy, active participation by the regulator, and a framework for funding.

## Is there a political will to implement change?

Clearly not under the present Government.  However, that stance may have to change in the near future given the mounting financial pressures on universities.

Government has signalled a broader review of HEI regulation and financial sustainability through the OfS's ongoing market exit workstream. Indeed, the OfS's own guidance on market exit has become more prescriptive, suggesting a regulator which is more than aware that existing tools are inadequate. Several parliamentary questions and select committee hearings have highlighted the absence of a special regime, and comparisons with the regime for FEIs have attracted attention.

However, legislative time is always scarce and implementing new insolvency regimes are not headline-grabbing priorities for MPs unless, of course, a university actually fails.

*The uncomfortable truth is that it may take a university collapse, resulting in significant disruption to thousands of students, and the public spectacle of an insolvency practitioner closing departments and making redundancies to generate the political urgency to legislate. That would be a painful and entirely avoidable way to learn the lesson that other regulated sectors learned years ago.*

## Concluding remarks

The financial pressures facing universities are not going away. If anything, they will only get worse.

The case for a new special administration regime for HEIs or, at minimum, a graduated special measures regime and/or a student transfer of last resort mechanism, involving regulatory oversight and centralised financial support, with special administration as a last resort, remains a compelling one and, very clearly, in the public interest.

The absence of a bespoke insolvency framework for HEIs with the objective of protecting outcomes for students is untenable given the financial crisis that is engulfing the sector. The regime for FEIs shows it can be done; the NHS and SOLR models show how it can be done well. At the very least, there is need for an early warning system or protocol to assist a financially distressed university to manage insolvency risk and clarify when the OfS will intervene to avert a disorderly exit. The appointment of special administrators would be a last resort option after graduated intervention measures have been exhausted and there is no reasonable prospect of avoiding an administration or liquidation. The current 'standard' regimes of administration and liquidation in the IA 1986, with no formal role for the OfS to intervene, and no 'learner protection' statutory objective, are not fit for purpose in the context of a failing university (with the possible exception of appointing 'Carillion-style' special managers but that option has significant shortcomings and challenges).

**The awkward question remaining for policymakers is not really whether to act in relation to HEIs; rather, it is whether to act before or after the collapse of a university that makes legislation inevitable.**

*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.*

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[1] The OfS requires HEIs to have a student protection plan in place as a condition of registration under section 13 of HERA 2017. A student protection plan is defined as a plan for the protection of students if an event specified by the OfS were to occur, with the closure of a course given as an example. However, these student protection plans are unlikely to be sufficient in the event of a university failure because there is no statutory insolvency procedure designed to prioritise student

 

protection or ensure continuity of studies.  Student protection plans depend on the provider having sufficient financial resources to implement them.

[2] See at paragraph 118 and the recommendation for such a system to be established with urgency.

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