

## **Insolvency**

**December 2018, 2569w**

**© David Palfreyman and Dennis Farrington, 2018**

### **A DISCUSSION PAPER - BAIL-OUT OR 'MERGER' OR CLOSURE FOR A FINANCIALLY FAILING UNIVERSITY?**

- 1. The politics of HE in recent years have seen the development of a market-style context for the delivery of a business service to fee-paying students-qua-consumers and also talk of entry-barriers being reduced so as to welcome additional for-profit commercial entrants bringing greater competition even at the new risk of there needing to be 'market exit' by some uncompetitive incumbents - all as duly enshrined in the Green/ White Papers leading to the Bill that became the Higher Education and Research Act 2017 (HERA17): see Palfreyman & Tapper, 'Reshaping the University: The Rise of the Regulated Market in Higher Education' (Oxford University Press, 2014) for 'the politics of higher education' context.**
- 2. This leaves the issue of whether the new regulator created under HERA17, the Office for Students (OfS), can and will rescue or bail-out a financially failing University (or Higher Education Provider, a HEP, as a University becomes in the language of HERA17 once duly registered with the OfS). Or does the OfS stand by, watching the HEP become insolvent, be liquidated and be closed down? – with the risk that its concerns for the protection of the consumer interest of the fee-paying students by achieving an orderly market-exit are perhaps overwhelmed in the formalities of liquidation procedures? Or does the OfS quietly 'assist' the failing HEP to 'merge' with a financially viable neighbour? Or does Government step in over the OfS and sort it all out because a significant employer is involved in a part of England where the regional economy and employment are not buoyant?**
- 3. It is widely assumed that any financial failure will be among the 'new' ex-poly post-92 'recruiter' HEPs (leaving aside small newish for-profit HEPs) rather than among the pre-92 'old' and**

**‘selector’ HEPs. The former are generally statutory higher education corporations (as HECs) rather than chartered corporations like the latter: although a few are run as charitable companies under the Companies Act 2006. Insolvency could, of course, arise at an over-borrowed chartered HEP facing a cash crisis in paying the interest on its bond debt, but for the purposes of this Discussion Paper we will take it that the insolvency risk is concentrated in the HEC HEPs facing student recruitment problems arising from their difficult market position based on their perceived low brand value: NB we do not, therefore, seek to address the issues of a financially failing chartered university nor of the HEP embedded within a financially failing further education corporation (and indeed we ignore the question of an insolvent for-profit HEP). See Farrington & Palfreyman, ‘The Law of Higher Education’ (Oxford University Press, 2012), re the legal status/format of universities: a new third-edition is due in 2020. This Discussion Paper does not offer any definitive view as to what is or is not possible; it merely flags a possible route through the maze, acknowledging that known-unknowns remain as issues: hence its title as a ‘Discussion Paper’!**

- 4. The Education Reform Act 1988 (ERA88) created the HECs and s128 gave the Government power to dissolve (or in effect to merge) an insolvent HEC, determining where its assets would go after liabilities had been met – or even transferring both, but presumably on the basis the former exceed the latter from the perspective of the recipient entity which can otherwise refuse to accept the poisoned chalice! Now Schedule 8 of HERA17 inserts from 1/8/19 a new s127A into ERA88 that allows for the HEC itself to ask to be dissolved rather than awaiting the Secretary of State (let’s say SofS or ‘the Minister’) to decide its fate – over and above whether the OfS under its ss18 & 45 HERA17 powers is, say, pushing a HEP into insolvency by deregistering it and stripping away its degree-awarding licence. And, presumably, the Minister can’t seek to protect any such assets from being caught up in the insolvency/liquidation process to pay off the HEP’s range of**

**creditors (including, say, the HMRC, its pensions liability, the redundancy payments to staff) just because the Minister under s128 ERA88 is designating asset X for transfer to entity Y? – but s127A might perhaps allow the formality of the insolvency process to be avoided, so that an orderly market-exit can be achieved (including, importantly, the funding of the Student Protection Plan – SPP – as required by the OfS as a condition of registration allowed under HERA17 and hence as a liability to be financed from the assets of the HEC)?**

**5. The wording of these two key clauses from ERA88 needs spelling out:**

- **s128, ERA88 – The SofS ‘may by order provide for the dissolution of any higher education corporation and the transfer of property, rights and liabilities of the corporation to any [entity] appearing to the [SofS] to be wholly or mainly engaged in the provision of educational facilities or services of any description [so, back, say, to the LEA that once funded the ex-poly HEP?], any body corporate established for purposes which include the provision of such services [so, another HEP, even an academy chain?], a higher education funding council [the UFC or PFC, later HEFCE; now the OfS under s127A below]; [but any such transfer must be on the basis that the transferee consents to receive the assets and is to treat them as held for charitable purposes] [and the SofS ‘shall consult the corporation [being dissolved] and the [funding council]...’]. This s128 lapses from 1/8/19.**
- **s127A, ERA88 – ‘If requested to do so [by a HEC, the SofS] may make an order providing for the dissolution of the corporation, and the transfer of property, rights and liabilities of the corporation to – [as in s128 above except that under iii) it is] the Office for Students [and the transferee must consent, while also if a transferee is not already an charity educational charity – for example, the OfS or even a for-profit HEP] any property transferred must be transferred on trust to be used for charitable purposes which are exclusively educational**

**purposes'. This new s127A wording replaces s128 above from 1/8/19.**

- 6. So, from the above – Can the OfS bail-out and rescue a financially failing or technically insolvent HEP? Might the OfS be able to engender the ‘merger’ of the stricken HEC HEP with another entity (or entities)? Could the Government step in directly to do provide a financial rescue?**
- 7. Under s68 HERA17 the OfS has a duty to monitor and report on the financial sustainability of the HE industry as the collective of its HEPs, but it has no statutory responsibility to rescue any particular HEP (and its Board Chair has recently said that anyway it will not do so). And, under s77 HERA17 the Minister can’t instruct the OfS to provide a bail-out package to a specific HEP – UNLESS the Minister is giving to the OfS ‘financial support directions’ in relation to ‘a particular registered [HEP]’ where and only where ‘it appears to the Secretary of State that the financial affairs of the provider have been or are being mismanaged’ and the OfS plus the provider have first been ‘consulted’ by the SofS. Such ‘financial support’ would be made by the OfS under s40 HERA17 as ‘grants, loans or other payments’ to the HEP on whatever ‘terms and conditions’ (s41) ‘as the OfS considers appropriate’ (having consulted ‘with such persons as it considers appropriate’). Presumably, given the statutory duty upon the OfS as a regulator to use its resources ‘in an efficient, effective and economic way’ as well as reaching its decisions in a ‘transparent, accountable, proportionate and consistent’ way (s2(1) HERA17), the OfS will need to carefully risk-assess whether the provision of any such ‘financial support’ would do the job in terms of bailing-out the stricken HEP and perhaps need to be especially rigorous in calculating whether there is a realistic chance of any ‘loans’ being repaid. So, the answers to the questions posed in para 6 appear to be: Yes, the OfS can bail-out a HEP but is not required to and, leaving aside how it would fund any such financial rescue, it has said it will not do so. Yes, the OfS, if indeed minded to intervene, could seek to engender a merger. And Yes, the**

**Government can step in directly by ordering the OfS to do so (and perhaps duly providing the extra funds for it to do so?) – but only where the Government asserts ‘the affairs of the provider have been or are being mismanaged’ and only after the Government has ‘consulted’ with the OfS and also the provider.**

- 8. Presumably, IF insolvency is ever a reality at a Coketown Met the Minister, upon being asked by its Governing Body under s127A ERA88 to dissolve the HEC, might, with the advice of the OfS, decree that CM’s assets (hopefully there are to be some after the dissolution process has paid off all its creditors) are to transfer to, say, the nearby and more financially sound Barchester University (with its consent) in return for BU effectively taking over the demise of CM (supervising any ‘teach-out’ under CM’s SPP, absorbing some staff and student numbers, managing the former CM site(s) while asset-stripping these assets as appropriate by way of compensation for BU taking on the tidying-up task) – much as happened when University College Cardiff was ‘merged’ with UWIST to create Cardiff University in the late-1980s: the former became financially unstable, the Government injected some £20m to deal with a cumulative deficit, and the adjacent well-managed University took over UCC (see Shattock, ‘The UGC and the Management of British Universities’ (SRHE & Open University Press, 1994), ch 6). Or, if any neighbouring HEP is wary of taking on such a task or if there are no near neighbours, the OfS could be the entity inheriting assets/liabilities and managing the dissolution. Similarly, if in fact ss77 & 40/41 HERA17 have been used as in para 7 above to attempt to rescue the HEP from insolvency but any such attempt has failed, the Minister under s127A ERA88 can presumably use (part of) the dissolved HEP’s assets to refund the OfS for the monies (grants or – more likely? – loans) used in trying to avoid the disorderly market-exit.**
- 9. See OxCHEPS Occasional Paper 64 re the potential personal financial liability of HEC governors as charity trustees were the HEC’s insolvency to arise from their reckless/gross**

**negligence and mismanagement in conducting the affairs of the HEP. Referring back to para 7, it seems unlikely, given this risk of personal financial liability, the governors would agree in any consultation with the Minister under s77 HERA17 that there had been or is now financial mismanagement, while for the Minister nonetheless to decree there had been or is when issuing instructions to the OfS to provide financial help to the HEP might risk the Minister being sued for defamation by the HEC's GB if the members of the GB did not accept there had been or was financial mismanagement (and even if in the consultation the OfS had advised the Minister that there had been or was evidence of 'the financial affairs' of the HEP being 'mismanaged')! If, however, the HEP is in trouble not because of any mismanagement but simply because, say, fewer young people want to enter HE (as may be an emerging trend) and/or (as certainly at present, 2018/19) there is a dip in the supply of 18/19 year olds, then it seems there is no power for the Government to take the initiative and step in so as to arrange a rescue via the OfS, whether or not the OfS thought such a rescue was appropriate and despite the HEP itself doubtless being keen to be rescued and thereby remain a going-concern. The OfS could seek to rescue the HEP but has said it will not do bail-outs, and anyway may have no funds to do so. Moreover, since a HEC HEP within that part of the HE market that might be in financial trouble because of falling student recruitment is likely to be in receipt of hardly any REF funding from the UKRI and also will be getting very little STEM top-up grant from the OfS, the public monies at risk by way of direct grant funding are much less than was the case with UCC (see para 8) when Government action was justified under the Minister's or rather his Permanent Secretary's accounting officer duty to the Public Accounts Committee concerning the safety of taxpayer funds.**

**10. In conclusion, two thoughts while answering this Discussion Paper's title as, broadly, in relation only to HEC HEPs: bail-out and rescue? – ABSENT THE MINISTER DECLARING UNDER s77 THAT THE HEC IS BEING MISMANAGED, NOT LIKELY (EVEN IF**

**LEGALLY/TECHNICALLY POSSIBLE/AFFORDABLE FOR THE OFS AND EVEN IF POLITICALLY DESIRABLE FOR THE MINISTER) ; 'merger' by way of dissolution? - VERY POSSIBLY AS POLITICALLY ACCEPTABLE ; and closure as formal dissolution? - PROBABLY INEVITABLE (EVEN IF THE LOCAL CAMPUS AND SOME VESTIGE OF THE NAME IS RETAINED WITHIN THE 'MERGER')...**

**11.Thought One: Perhaps the trick in handling a financially failing HEC HEP so as to achieve an 'orderly market-exit' (given that a bail-out/rescue to keep it as a going-concern seems unlikely) will be to avoid the HEP technically entering into insolvency by instead s127A being triggered by the HEP itself (assuming its Governing Body can accept the end is nigh). The Minister and the OfS need to scenario-plan the s127A process so that there can be a co-ordinated effort (as happened with the UCC instance set out in para 8 above – although UCC was, of course, a chartered charitable corporation and not a HEC; with the UGC and the Department acting in unison once the UCC Council had been persuaded it was time to ask for aid – and it also sought help in assessing the extent of the financial deficit by calling in a team from the University of Warwick led by its Registrar, Michael Shattock OBE, and that team included one of the authors of this Discussion Paper - Palfreyman). So, s127A is of potential use for a post-92 HEC in financial trouble (unless structured as a charitable company post-92? - as, say, LMU), enabling the Minister to transfer the problem (assets hopefully eventually exceeding liabilities) to the OfS Board; and the UCC story is worth revisiting if faced with a chartered HEP encountering difficulties (even if structured as a charitable company? - such as LSE), and assuming as with UCC it is possible to find some £XXm down the side of a Treasury sofa; but a for-profit commercial HEP can be dealt with only under the Companies Act 2006 and the Insolvency Act 1986.**

**12.Thought Two: The use of s127A might also, crucially, allow the potentially complicated and costly liability by way of the effective operating of the HEC's SPP (as the hoped-for**

**protection of the student consumer interest) to be met by the OfS as part of the liabilities transferred, hopefully along with the eventual sale of property/assets fully covering that cost; whereas otherwise in the event of formal insolvency being triggered the liquidation process might not protect the monies needed to fund the SPP.**

**David Palfreyman OBE MA MBA LLB FRSA (writing in a purely personal capacity and NOT as a Member of the Board of the OfS) and Dennis Farrington BSc DPhil LLB LLM FRSA**

.....