



Department  
for Business  
Innovation & Skills

**Further Education and Sixth Form  
Colleges**

Consultation on Developing an  
Insolvency Regime for the Sector

JULY 2016

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# Consultation on Developing an Insolvency Regime for the Sector

This consultation seeks comments on proposals to introduce procedures for further education and sixth form colleges which become insolvent (unable to pay their debts). The proposals include a Special Administration Regime which would give extra protection to ensure continuity of service.

The insolvency regime would be designed to:

- Protect learners from disruption to their courses;
- Help the rehabilitation of the college, where possible; and
- Provide an orderly winding up procedure if a college becomes insolvent.

We are proposing insolvency procedures for colleges in line with those provided for companies under the Insolvency Act 1996, including administration and liquidation.

**Issued:** Wednesday 6 July 2016

**Respond by:** Friday 5 August 2016

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This consultation is relevant to:

- Further Education and Sixth Form Colleges, their staff and students
- Creditors of Further Education and Sixth Form Colleges

## 1. Foreword

Further education and sixth form colleges are critical in helping to improve national productivity by responding to local employers' needs and providing skilled workers for the labour force. This includes their role in delivering on our 3 million apprenticeship commitment by 2020.



The college sector is undergoing change with Area Reviews seeking to meet each area's educational and economic needs and to put the sector on a sustainable footing and to build financial resilience supported by a Restructuring Facility.

Colleges need to be able to access the appropriate legal mechanisms to address financial issues and to make arrangements appropriate to their commercial situation. Equally, learners are entitled to education and training from strong, responsive and high quality institutions.

The Government is rightly supporting the sector through this transition. Once the Area Review recommendations have been implemented, colleges, learners, creditors and taxpayers need to know that the corporations will continue to operate on an autonomous basis both financially and operationally.

Currently, the legal regime for colleges does not make clear how insolvent institutions should be dealt with. This anomaly cannot continue indefinitely. After the Area Reviews, colleges will need a legal framework within which to manage their finances independently and flexibly, with opportunities to restructure and protections for learners. Any framework will need to make provision for corporations to exit the market when appropriate and without undue detriment to learners, creditors and taxpayers.

The regulation of further education and sixth form colleges must evolve to champion independence and financial resilience, to protect learners and taxpayers and to provide clarity for college creditors. We plan to establish a comprehensive insolvency regime for the sector with a clear remit to provide flexibility where colleges can be rescued and clarity of process where they cannot.

This proposal reflects our mission to create resilient, responsive and independent further education and sixth form corporations and to protect our learners.

I encourage everyone with an interest in further education to feed in their views.

A handwritten signature in black ink, appearing to read 'Nick Boles'. The signature is fluid and cursive.

Nick Boles, Minister of State for Skills

## 2. Executive summary

1. This document seeks comments on options for clarifying the statutory framework relating to further education and sixth form college insolvency, including a Special Administration Regime (SAR) which is designed to protect learner provision and to provide orderly winding-up procedures in the event of a college becoming insolvent.
2. The further education (FE) and sixth form (SF) college<sup>1</sup> sector is in a period of transition. Following changes in the Education Act 2011, colleges have become more autonomous, with greater freedoms and flexibility to take decisions and respond to the needs of learners and employers, and more independent in financial decision making. Many colleges swiftly adapted by reducing their costs and increasing their incomes from other sources, including higher education provision, apprenticeships and bespoke training schemes. A large majority are currently rated as having at least “satisfactory” financial health and operate competitively as providers of high quality education. However, a significant minority responded less effectively to these changes, with some colleges rated as having inadequate financial health.
3. In 2015, a programme of Area Reviews was launched across England with the aim of ensuring high quality, sustainable provision capable of meeting the future needs of learners and employers. A key objective of the reviews is to facilitate any structural changes required to deliver institutions which are financially viable, sustainable, resilient and efficient, and provide maximum value for public investment. A Restructuring Facility is being made available to support colleges in implementing the recommendations of Area Reviews where that is required<sup>2</sup>.
4. The Government has also signalled its commitment to the sector by protecting the Adult Education Budget and 16-18 funding in the recent Spending Review and through its strong support for apprenticeships and Advanced Learner Loans; giving colleges a strategic opportunity to further diversify their funding base. Government – including both central Government and local Combined Authorities – will continue to have a strong interest in the financial resilience and sustainability of the college sector going forward. It will remain the provider of a large proportion of the sector’s funding, and will continue to have legal duties in respect of provision.
5. The Area Review process should significantly reduce the possibility of a financial failure in future, but it does not remove it altogether. It is important that arrangements for dealing with future insolvency are clear, and that learners are protected.
6. At present, the Further and Higher Education Act 1992 makes no provision for the treatment of insolvent colleges. Where a college is insolvent, another provider may still step in to accept its assets and liabilities to allow it to dissolve, but this is unlikely in practice. Where a recipient provider does not come forward, it is unclear whether insolvency law relating to compulsory winding-up currently applies to colleges. If it

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<sup>1</sup> For the purposes of this document, the terms “college(s)” and “corporation(s)” are used interchangeably and include both further education and sixth form colleges. The existing legislative framework provides for a different position in relation to disposal of assets for certain sixth form colleges designated under section 33J of the Further and Higher Education Act 1992

<sup>2</sup> <https://www.gov.uk/government/publications/post-16-education-and-training-institutions-area-based-reviews>

does, it would be possible for a college to be wound up by the court. However, this is untested; and in any event would not provide the range of procedures that would offer flexibility for colleges and their creditors or protections for their learners.

7. This uncertainty creates the risk of disorderly closures and potential detriment for learners as their courses are interrupted or terminated, as well as potential adverse outcomes for creditors, and the taxpayer. It can also result in distorted incentives for colleges when making commercial decisions.
8. It is important that any new insolvency regime provides an orderly process for insolvent colleges to close, protects learners from disruption to their courses, respects existing independence of colleges and enables colleges to be rescued where possible.
9. The proposed insolvency regime for further education and sixth form colleges will establish a clear and well understood framework for the benefit of colleges, learners, creditors and taxpayers. We are proposing to establish a full suite of insolvency procedures for colleges, broadly in line with those afforded to companies under the Insolvency Act 1986 (IA86), including: administration and voluntary arrangements, so facilitating the rehabilitation of a college where possible; and where not, an orderly winding-up through voluntary or compulsory liquidation. It is intended that under the proposed college SAR, continuity of service will be protected for learners.

### 3. How to Respond

10. When responding, please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation form and, where applicable, how the views of members were assembled.

You can reply to this consultation online at:

<https://bisgovuk.citizenspace.com/ve/consultation-on-developing-an-insolvency-regime-fo>

Consultation opened on: 06 July 2016

Last date for responses is: 05 August 2016

11. The consultation response form is available electronically on the consultation page. The form can be submitted online/by email or by letter to:

Benjamin Dance  
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Tel: 0207 215 4839  
Email: [FEconsultation@bis.gsi.gov.uk](mailto:FEconsultation@bis.gsi.gov.uk)

12. A list of those organisations and individuals consulted is in Annex 2. We would welcome suggestions of others who may wish to be involved in this consultation process.
13. You may make printed copies of this document without seeking permission.

The standard electronic version is at:

<https://www.gov.uk/government/consultations/developing-an-insolvency-regime-for-the-further-education-and-sixth-form-sector>

14. Versions of the document in Braille, other languages or audio-cassette are available on request.

## 4. Confidentiality and Data protection

15. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
16. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

## 5. Help with Queries

17. Questions about the policy issues raised in the document can be addressed to:

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18. The consultation principles are at Annex 1.



## 6. Background

19. Further education (FECs) and sixth form (SFCs) colleges are statutory corporations incorporated under the Further and Higher Education Act 1992. They are also exempt charities regulated by the Secretary of State for Business, Innovation and Skills (SoS BIS) and the Secretary of State for Education (SoS DfE) respectively. There are currently 241 further education colleges and 92 sixth form colleges providing education and training to people in England (education is a devolved matter in Scotland, Wales and Northern Ireland).
20. The further education and sixth form college sector in England is in a period of transition. Since 2010, the sector has become increasingly independent. The Education Act 2011 reflected the Government's policy of freedom and flexibility for colleges by removing some restrictions and controls to enable them to respond more effectively to the needs of learners and employers in sourcing funding and making decisions on day-to-day operations. Many colleges responded swiftly and a large majority are currently rated as having at least "satisfactory" financial health. They adapted by reducing their costs and increasing their incomes from other sources, including apprenticeships and bespoke training schemes. However, some colleges are rated as having inadequate financial health, demonstrating that a significant minority have not responded effectively to changes within the sector.
21. Looking to the future, the post-16 education sector is critical to our strategy of raising productivity and economic growth. England needs strong education and training institutions which have high status and are genuine centres of expertise capable of providing quality learning and delivering three million apprenticeships by 2020. On that basis, the Area Reviews were established in September 2015 to support restructuring of the post-16 education and training sector by assessing the structural changes required to improve local provision, including mergers or closure of colleges. The Area Reviews seek to ensure that the further education and sixth form colleges meet their local area's education and economic needs and that they are financially viable, sustainable, resilient and efficient. The reviews commenced in 2015 and are due to conclude in 2017 with full implementation expected in 2018.
22. Under the Further and Higher Education Act 1992, colleges<sup>3</sup> are able to transfer their "property, assets and liabilities" to another willing party in order to dissolve. However, the Act does not provide for what should happen if there is no such willing party, most likely because the liabilities of the dissolving college exceed its assets. We no longer consider that the existing arrangements under the Act adequately address the solvency issues that colleges may face; nor does it provide for an orderly process to wind up insolvent colleges. There is a need for a clear insolvency regime which protects colleges' learners and creditors should the college fail. The sector's capacity to operate effectively is compromised where there are barriers to exit and commercial decisions are not directly linked to financial implications. It impinges the long-term success of the sector and delivers sub-optimal outcomes for learners, creditors and taxpayers.

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<sup>3</sup> As mentioned above, the existing legislative framework provides for a different position in relation to disposal of assets for certain sixth form colleges designated under section 33J of the Further and Higher Education Act 1992.

23. In practice, Exceptional Financial Support (EFS)<sup>4</sup> has been used to protect learners and avoid disorderly closures where prior interventions have been unsuccessful or creditors move on college debts. There is no obligation on government to provide such exceptional funding however; and whilst the Area Reviews are expected to leave colleges in a more stable position, we cannot assume colleges will never become insolvent.
24. The corporate insolvency regime seeks to provide equal, fair and orderly procedures by which to handle the affairs of insolvent companies, providing mechanisms for rescuing businesses and for ensuring an equitable distribution of the assets amongst creditors. It also seeks to minimise delay and expense and where appropriate enable both debtors and creditors to be involved in resolving the insolvency. The proposed regime for colleges builds on these principles to ensure protection of learner provision, as well as clarity and rights for creditors which are comparable with the position applying to companies.
25. It is unclear whether insolvency legislation currently applies to further education and sixth form colleges. Section 221 of the Insolvency Act 1986 (IA86) provides that an “unregistered company” can be wound up by the court. However, it is unclear whether a further education and sixth form college falls within the definition of “unregistered company” under Section 220 of the IA86. The legal arguments are finely balanced and ultimately only a court can determine the issue. If further education and sixth form colleges are to be regarded as “unregistered companies” then they would be subject to the compulsory winding-up procedures in the IA86, leading to a reasonably orderly regime on normal insolvency principles including, where there are sufficient funds, *pari passu*<sup>5</sup> distribution to unsecured<sup>6</sup> creditors. If not, there would likely be a disorderly outcome in the event of the insolvency of a college, with unsecured creditors claiming on an unequal “first past the post” basis.
26. The proposed insolvency regime will build on the existing legislative framework, based on the process of administration and liquidation with appropriate changes to tailor the procedures to the requirements of the sector. Some of the main factors influencing and underlying the proposals are:
  - Establishment of an orderly process which provides protections for creditors comparable with other relevant UK insolvency regimes
  - Protection of the interests of learners by promoting continuity of provision
  - Retention of independence and freedoms of colleges (as expanded by the Education Act 2011) whilst removing or mitigating any expectation of additional exceptional public funding
  - Support for local and national education and training needs

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<sup>4</sup> Link to policy document: <https://www.gov.uk/government/publications/further-education-colleges-financial-intervention-and-exceptional-support>

<sup>5</sup> On an equal basis, proportionately to amounts owed

<sup>6</sup> Unsecured creditors have no security over the insolvent corporation’s assets in respect of the debt due to them

- In cases where it is feasible, facilitation of the rescue of the FEC / SFC as a going concern, including access to new financing
  - Maintaining and maximising the value of the assets of the FEC / SFC
  - Creating a legislative context in which commercial lenders will continue to look to lend to colleges on appropriate terms.
27. The proposed regime is technical in nature and this document therefore provides a general overview and explores certain technical details. We would welcome your views on both the overall design of the regime and the technical details.
28. In particular, the consultation considers the:
- Need for legislation and an insolvency regime for colleges in England;
  - Entry routes to the insolvency regime;
  - Proposed Special Administration Regime objective;
  - Options for protecting service provision; and
  - Exit routes from insolvency.

## Timing

29. The proposed insolvency regime would require primary legislation. Subject to the consultation outcome, we would seek to introduce measures to legislate when Parliamentary time allows.

## Scope

30. It is envisaged that the proposals contained in this consultation will apply to further education and sixth form colleges in England only. However insolvency is a matter for Westminster in relation to England and Wales and any proposed changes to insolvency legislation could also be applied to colleges in Wales. We are consulting with the Welsh Government and would welcome views from colleges and other stakeholders in Wales on whether to apply these provisions to colleges in Wales.
31. We do not propose to legislate in relation to Scotland or Northern Ireland as different legislation governs this matter in these territories.

## Specialist Designated Institutions (DIs)

32. The proposals relating to colleges do not cover specialist designated institutions. Some FE bodies have been designated under section 28 of the Further & Higher Education Act 1992 as institutions “grant-aided or eligible to receive aid by way of grant if it is maintained by persons other than local education authorities.”<sup>7</sup> They are registered as charities with the Charity Commission, and subject to the provisions of the Charity Acts.
33. These bodies have different legal form to further education and sixth form colleges. The majority of designated institutions are companies and as such are already subject to insolvency procedures. We propose to allow the SAR to be applied to those designated institutions that are companies, should they become insolvent.
34. We also considered whether to extend the proposed insolvency regime, including the SAR, to the three designated institutions that are not companies. However, given the way that they are structured and funded, it would seem unlikely that they would fall into a position of insolvency. Due to their legal nature, the application of a SAR to these specific DIs would be significantly more complex than its application to either colleges or DIs that are companies. A SAR would also be limited in its potential application to these types of DI because of their high degree of specialisation, making it difficult to transfer learners at these institutions to suitable alternative providers. For these reasons we only propose to extend the SAR provisions to those designated institutions that are companies.

**Question 1: Do you agree that only the SAR element of this regime should be applied only to Designated Institutions that are companies? Please give reasons for your answer.**

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<sup>7</sup> <http://www.legislation.gov.uk/ukpga/1992/13/section/28>

## 7. Proposals

### 7.1 Need for a legislative Approach

35. The Government has made clear<sup>8</sup> that going forward it would expect that only colleges who actively ensure that they are financially sustainable and can deliver good quality provision for learners and employers should receive public funding.
36. Colleges are independent institutions. Government provides much of their funding and has no additional commitment or liability to protect the integrity of institutions with unsustainable debts, or their creditors. Without any change in legislation, insolvent colleges could be brought directly and unpredictably through the courts by their creditors, facing what may be a long and costly process to deal with remaining assets and close the college's business. In such a situation, and without a specific provision in place, Government's overarching principle would still be to seek to protect learners as far as possible, but this would be made more difficult by the lack of a specific regime and ultimately the courts would determine the outcome.
37. The risk of unmanaged change is recognised and in developing these proposals we have reflected on non-legislative routes by which learners could be supported. This could include potential preferred-creditor protection arrangements for students in the event of insolvency with possible bonds providing security to learners or escrow arrangements protecting learner fees paid in advance by setting them aside in trust. We have also considered establishing insurance packages to protect students' fees and allow for their funding to be transferred to another college to continue their learning without it being lost to settle other debts. We consider such arrangements for learners would be prohibitively expensive and it would require tighter regulation of the sector to ensure compliance. It would do nothing to protect continuity of provision of learners generally and would also impose costs on financially stronger colleges, as well as weaker colleges.
38. Given Government's over-riding objectives of providing for learner protection without the need to financially support non-viable colleges, whilst also providing for orderly processes and rescue mechanisms for colleges which fail financially, we do not consider that there are any other measures that would offer equal or better protection to learners who have been placed in difficulty as a result of an institution becoming insolvent and meet these other key objectives. We therefore consider that in order to protect learners in the event of a college becoming insolvent and meet the other objectives, it is necessary to introduce an insolvency regime for FE and sixth form colleges that addresses the specific characteristics of the sector.

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<sup>8</sup> See: [www.gov.uk/government/publications/post-16-education-and-training-institutions-review](http://www.gov.uk/government/publications/post-16-education-and-training-institutions-review) and [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/459845/BIS-15-526-reviewing-post-16-education-and-training-institutions-guidance-on-area-reviews.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/459845/BIS-15-526-reviewing-post-16-education-and-training-institutions-guidance-on-area-reviews.pdf)

## 7.2 Proposals for an insolvency regime

39. This policy aims to deliver options for the rehabilitation of a college where possible and if not, to promote an orderly winding up with protections for learners and creditors. We believe it is in the best interests of colleges, learners and creditors, to have the flexibility of a number of options in the event of insolvency including rescue and voluntary or compulsory wind up. The proposals closely mirror the insolvency arrangements afforded to companies under the Insolvency Act 1986 and would be provided through new primary and secondary legislation.
40. The proposed regime would include:
- Company Voluntary Arrangement<sup>9</sup>
  - Administration
  - Compulsory Liquidation
  - Creditors' Voluntary Liquidation
41. In addition, we propose to establish a Special Administration Regime (SAR) for colleges which will sit alongside the above options. It would be triggered where a college becomes insolvent and the Secretary of State<sup>10</sup> deems it appropriate to apply for a SAR to protect learner provision.

### Company Voluntary Arrangement (CVA)

42. A CVA provides for an arrangement on debts between a company and its creditors to allow the company to avoid liquidation by entering an agreement binding at least on all unsecured creditors. A CVA can be used as part of a wider arrangement or restructuring. It is often used for short-term or one-off debt problems and is supervised by an insolvency practitioner.
43. CVAs would be an attractive option for colleges because they do not, as a matter of course, require court intervention and would potentially give more control to both the college (as the college governors would remain in control) and the unsecured creditors (as they can vote against the agreement if they wish). In a CVA, the insolvency practitioner only monitors the arrangement (as supervisor); control would lie with the college at all times (unless already in administration or liquidation).

### Administration

44. Administration provides for a number of possible outcomes: the college could be reorganised (including via a CVA), it could be sold as a going concern in its entirety or in part, or the administrator could decide to put the college into liquidation. If the administrator recommends that the college enter liquidation, it can do so via compulsory or creditors' voluntary liquidation.

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<sup>9</sup> The official name for this process is Company Voluntary Arrangement. We continue to use this title as it is well understood, but have considered how it could apply to colleges.

<sup>10</sup> For further education colleges it will be SoS Business, Innovation and Skills and for sixth form colleges, it will be SoS Education

45. Administration for colleges would operate, as for companies, subsequent to or in place of a CVA. An insolvency practitioner (“IP”) would be appointed as administrator to replace the governors and could either retain or change the principal, and ensure the college still operates (at least for a period while proposals are worked up by the administrator). A statutory moratorium would be automatically imposed which would prevent creditors enforcing claims and provide breathing space to allow the administrator to reorganise the college’s affairs or sell assets, whichever they deem most appropriate, without immediate pressure from the creditors.
46. The administrator would prepare a statement of proposals to share with the creditors and college governors. In some circumstances, the college’s creditors would then get to vote on the proposals. If asked, over 50% (in value), must vote in favour to approve the proposals. If approved, the proposals would be taken forward and the college would continue to operate under the administrator. If rejected, the administrator would look to the court on how to proceed.
47. In an administration there is no automatic termination of employment contracts so the administrator could choose to retain college staff to continue the college’s operations.<sup>11</sup> In such cases this would provide for service continuity and minimises the disruption that students will suffer, especially at short notice. The automatic moratorium would provide space to examine the opportunity for college rehabilitation, where funding is available. If there were not sufficient funds available, the administrator would have no alternative but to close the college. This would protect the interests of creditors, but may not allow the administrator to take action to protect the learners. A SAR will ensure that the interests of learners are given priority and the administrator is able to act accordingly.
48. As with companies, the college administrator would have 12 months to execute the proposals, at which point their appointment would be terminated. It could be extended by the court or by agreement with college creditors. Alternatively, the administrator could apply to the court for a termination at any point during administration.

## Compulsory Liquidation

49. Compulsory Liquidation, also known as winding up by the court is where a petition is made to the court that a company is wound up. There are a number of possible applicants including the company itself, but in the vast majority of cases of compulsory liquidation of companies, the petitioner will be a creditor for an unpaid debt.
50. Applying this to FE and sixth form colleges, when the court grants a winding-up order, a liquidator would be appointed and would take over the college. Other than where there has been a CVA or an administration immediately prior to the winding-up order (in which case, the former officer holder may be appointed), the liquidator would be an official receiver, at least in the first instance. The governors and principal would be dismissed upon the making of the order. There are limited grounds on which a

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<sup>11</sup> An administrator will need to make a decision on staff within 14 days of his appointment, as otherwise the contract of employment is taken as adopted.



liquidator can trade when a company is in liquidation and in the college situation, in all likelihood the liquidator would shut down the college as soon as they were appointed. These measures are in line with procedures for companies and charities where the directors/trustees are dismissed from office when a liquidator is appointed<sup>12</sup>.

51. The liquidator, once appointed, would gather together the college's assets and sell them, distributing the proceeds to the college's creditors in priority order; they would first pay fixed charge holders (from assets covered by a fixed charge), followed by the costs of the winding-up, then preferential creditors including wages and redundancy payments to employees (to statutory limits), and then unsecured debts. Liquidation would inevitably result in an immediate break in service provision. This is because the winding-up order would automatically terminate all employee contracts with immediate effect. Even if the liquidator sought to continue operating the college, they would have to rehire the necessary staff, including teachers, on short term contracts to carry out the functions required.
52. At the end of the liquidation process, it is expected that the college would be dissolved. This final process and outcome would be the same for voluntary and compulsory liquidation. It is very unlikely that a college entering liquidation would emerge and continue operating as before (in some cases elements of a business may emerge, but not the corporation itself).
53. We have considered the possibility of providing only for compulsory liquidation and not for other insolvency procedures such as administration and CVAs. Compulsory liquidation is an important process in an insolvency regime in that it would allow for an orderly winding up for insolvent colleges where creditors have been unable to secure payment by other avenues. It has the benefit of being a widely understood process and provides the clarity of a winding up by the court with an orderly distribution to creditors. However, learners would not be afforded any protection on continuity of provision, and very little prospect of rescue for colleges.

### Creditors' Voluntary Liquidation

54. In the case of companies, a creditor's voluntary liquidation (CVL) is a procedure whereby the company directors voluntarily bring the business to an end by appointing a liquidator. The liquidator is appointed at a creditors' meeting. This is different from a compulsory liquidation which is forced upon an insolvent company by the Court via a winding up order. In the case of applying a CVL to colleges, the governors (whom the proposed regime would treat as equivalent to a company's members) could resolve to wind the college up and where the college is insolvent<sup>13</sup>, this would be in the form of a creditors' voluntary liquidation.
55. The liquidation would be managed by a liquidator nominated by the creditors, or if no creditor nomination is made, by the governors' nominated liquidator. The liquidator would realise the college's assets for distribution to creditors in order of priority,

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<sup>12</sup> Once a charity becomes insolvent the trustees' duties change from being that of the best interest of the beneficiaries to that of the best interest of the creditors. If the liquidator removes all the trustees he would become the trustee, but only need to have regard to the duties of winding up the charity in the best way.

<sup>13</sup> Where no statutory declaration of solvency has been made in accordance with section 89 of the Insolvency Act 1986 (that the college will be able to pay its debts in full within the specified period),



depending on the nature of the creditor and any security held. It is unlikely that the liquidator would be able to provide for rescue of the college. Given that there will be more effective insolvency options which would support the rescue of the college, it is anticipated that the governors would use this where winding up was the only option.

56. Members' Voluntary Liquidation (MVL) is another process available under the Insolvency Act 1986, in cases where the directors of a company are able to swear a statutory declaration of solvency. We have not included this in our proposals because solvent colleges already have the option to dissolve under the Further and Higher Education Act 1992, so MVL would not provide any significant additional benefit to colleges, learners or creditors.
57. Taken as a whole, the "ordinary" insolvency regime as established for companies under the Insolvency Act 1986 provides clear mechanisms for handling insolvency and offers a more managed and flexible approach which could see an insolvent college restructured or where this is not possible, a well-understood and ordered process for winding up. It does not offer explicit protections on continuity of provision for learners. For such purposes we propose to establish a bespoke regime.

**Question 2: Do you think any of the insolvency measures summarised in our proposals (Company Voluntary Arrangement, ordinary administration, compulsory liquidation and creditors' voluntary liquidation) should be available in the event of college insolvency as well as a Special Administration Regime? Please explain your answers.**

## 7.3 Special Administration Regime for Further Education and Sixth Form Colleges

58. We propose to introduce a Special Administration Regime (SAR) for the sector. In addition to ordinary administration, the SAR will provide specific protection for continuity of learner provision. SARs are already used in other sectors (such as energy and postal services) to protect an overriding public policy objective such as continuing to provide an essential service.
59. For colleges, we propose the regime would be governed by a special objective focused on protecting the continuity of learner provision. The SAR would be used until a decision on the future of the college and its provision can be taken. The SAR, alongside the rest of our proposals, deals with a low probability, high impact event and would therefore be a tool of last resort when all other options to deal with the financial distress of the organisation have failed or would not be effective. The SAR would apply the provisions of the Insolvency Act 1986 relating to ordinary administration as far as possible and where appropriate apply key elements which have been used in other special administration regimes (for example the Postal Services Act 2011 and the Energy Act 2011), adapted as appropriate to the sector context.
60. The proposed SAR for colleges differs from other SAR regimes as they are often intended to secure continued provision of critical infrastructure (such as rail, energy or water), while an Education SAR may result in the winding up and dissolution of a college once the special objective of protecting learners has been met.
61. The proposed SAR would only be used where a college is unable to pay its debts or is likely to become unable to pay its debts' as defined in the normal definition of insolvency in section 123 as well as paragraph 11(a) of Schedule B1 of the Insolvency Act 1986. Like the rest of the proposals, the SAR is therefore only relevant in the case of a college which has failed financially.
62. The Secretary of State would apply to the court for the appointment of an 'education administrator' to develop a credible proposal. The education administrator may consider the following options to secure continuity of provision for learners:
  - i. Rescue the college as a going concern;
  - ii. Arrange for transfer of provision to another provider; or
  - iii. Allow learners to either transfer to another provider or complete their courses before the college is wound up and dissolved.
63. While the education administrator would be guided first by the special objective (see paragraph 69 below), they would also be required to have regard to the interests of creditors as a whole (see paragraph 76 – "General functions of an education administrator").
64. In order to minimise disruption to learners the administrator would have scope to ensure that any transfer of learners would take place at a natural break point in the academic year and would take into account any reasonable travel to learn distances when assessing alternative provision (in the same way as they are currently considered in the Area Review process).

65. The intention would be to create similar circumstances for learners to those which would apply at a solvent college. So, if a learner is undertaking or has signed up to a course, the administrator would be able, in principle, to honour that offer.
66. The administrator will need to consider how best to accommodate any learners with special education needs and/or disability (SEND), or other high needs in the process, particularly if there was a transfer of provision to an alternative provider. Government are considering how this will be done in practice.
67. Other provision should be transferred. The administrator would engage both the Combined Authority (where applicable) and the Local Enterprise Partnership in terms of potential impacts on the skills provision in the local economic area, but transfer may not be absolute. For example, costly courses may need to be terminated. The administrator could follow similar arrangements as solvent colleges currently apply.

### Rationale for the proposed option

68. Both the SAR and ordinary insolvency procedures provide a range of possible outcomes for the colleges, which will yield both protection for learners and an orderly outcome for creditors. The benefit of the SAR is to protect learner provision and therefore provide more time than normal insolvency procedures to mitigate the risk that a college is wound up quickly and in a way which, by focusing only on creditors, would be likely to damage learners. In addition, it will protect taxpayers by not propping up failing colleges indefinitely.

### Special Objective

69. The special objective for the education SAR will need to guide the administrator in all the actions they take for continuing of learner provision, and so will need to be clear in terms of what it means for learner protection, as well as the interests of the creditors. Subject to this consultation, we propose the following special objective:

*(1) The objective of an education administration is to:*

*(a) avoid or minimise disruption to the studies of the existing students of the further education body as a whole, and*

*(b) ensure that it becomes unnecessary for the body to remain in education administration for that purpose.<sup>14</sup>*

70. Statutory duties towards 16-18 learners would be protected<sup>15</sup>. The administrator will therefore need to take account of the need to maintain a local 16-18 offer which enables such young people to access suitable provision. The administrator will work

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<sup>14</sup> In effect, the administration will continue until the objective has been achieved. By existing students we have in mind any person who is a student at the college when the administration begins, or has accepted a place on a course at the college when the administration begins.

<sup>15</sup> Under the recent provisions for raising the participation age, all young people completing Year 11 from 2014 onwards have been required to remain in education or training until at least their 18th birthday. The education administrator will therefore need to take account of the need to maintain a local 16-18 offer which enables such young people to access suitable provision.

with the relevant local authority and the Education Funding Agency in reviewing and identifying any potential gaps and any action needed as part of the SAR to maintain the local offer.

## Special Administration Regime and Creditors

71. The administrator must, so far as is consistent with the special objective of the regime, carry out functions in a way that achieves the best result for the college's creditors, as a whole.

**Question 3: Does the proposed special objective sufficiently reflect the needs of learners and creditors? Please explain your answer.**

## Indemnity

72. Given that the role of education administrator is likely to involve insolvency practitioners carrying out functions that they may not undertake in ordinary insolvency procedures, as they would be required to achieve the education objective to continue the operation of the college, we recognise that it may be necessary to provide indemnities to ensure that IPs are willing to act in this capacity. We therefore propose to introduce provisions to allow the Secretary of State to provide indemnities (protections against liability) to specified persons, including the administrator and their employees.
73. Indemnities may be agreed in relation to liabilities incurred in carrying out the functions of an education administrator and for loss or damage sustained as a result. Such indemnities may be provided as part of the special financing arrangements for the SAR and will require disclosure to Parliament.

## Initiating a SAR

74. We propose that, in the event a college is unable to pay its debts, as defined in section 123 as well as paragraph 11(a) of Schedule B1 of the Insolvency Act 1986, the Secretary of State should be able to initiate a SAR on the same basis as for other SARs which relate to public services. The SAR would therefore start in one of two ways<sup>16</sup>:
- Secretary of State applies to the court for an SAR order; or
  - Where a college or its creditors petition the court for another type of insolvency order under the Insolvency Act 1986, the Secretary of State uses the statutory period to decide whether to initiate a SAR and apply for a SAR order. We propose that, as with other SARs, the statutory period should be set at 14 days.<sup>17</sup>

### Question 4: Do you have any comments on our proposals for SAR initiation?

#### Appointment of the education administrator

75. Once the court makes a special administration order, an appropriately qualified and suitably experienced insolvency practitioner nominated by the relevant Secretary of State would be appointed by the court as the administrator. The insolvency practitioner would be an officer of the court and the conduct of the special administration would be subject to the general supervision of the court. They would also be an agent of the college in carrying out its affairs. The notice of appointment would go into a suitable national publication.

#### General functions of education administrator

76. Where an education administration order is in force in relation to a further education body, the body's affairs, business and property are to be managed by the education administrator. The education administrator must carry out his or her functions for the purpose of achieving the objective of the education administration. The education administrator must, so far as is consistent with that objective, carry out his or her functions in a way that achieves the best result for the further education body's creditors as a whole.

#### The education SAR process

77. Under a SAR, the administrator would develop proposals to meet the special objective of securing provision for learners. Unlike in general administration, there would be no "decision" on the proposal by creditors or any other stakeholders, although Secretary of State would have to agree whether or not to fund the proposals.

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<sup>16</sup> This would be similar to the arrangements which apply to companies which are subject to other types of special administration

<sup>17</sup> This is the timeframe for the SoS to decide whether to initiate a SAR and to apply to the Court for a SAR order. In reality, the SoS would most likely be aware of the developing situation and the actual time period would probably be shorter. The 14 days does not indicate the time needed for an administrator to be appointed.

78. There would be no time limit to Special Administration Regimes. Ordinary administrations typically take around twelve months. SARs may need longer due to the fact that they relate to continuity of public services and so have a special objective to be fulfilled. They can also be extended if required.

## SAR Proposals

79. Where the education administrator concludes that the college cannot be rescued as a going concern, they may propose:
- a transfer of either part or all the provision including the learners and staff to another college;
  - a merger between colleges, including transfer of the assets and liabilities of the college in administration; or
  - if there is no possibility of a rescue or transfer, keeping the college running until the special objective has been achieved i.e. by enabling courses to be completed. The college would then be put into liquidation before being wound up.

## Transfer Schemes

80. The education administrator will be given the power to make transfer schemes which would transfer the property, rights and liabilities of a college during a special administration to another college. The types of things which could be transferred are as follows:
- Freehold and leasehold land;
  - Leases for equipment such as photocopiers;
  - Contracts for the supply of services or materials;
  - Contracts to provide fee-paying students with tuition;
  - Loan agreements with banks; and
  - Contracts of employment of teaching and other staff.
81. Transfer schemes can override third party rights such as the right of a landlord to object to the transfer of a lease or the right of a party to a contract to insist that any obligations owed to it are performed only by the other party to the original contract. However, a transfer scheme could help the education administrator to transfer provision where all or part of the undertaking of a further education body is being transferred to another one. The transferee body by nature is very likely to be financially stronger than the transferor.

**Question 5: What issues, if any, would you envisage if transfer of provision of assets/liabilities were required?**

## Funding the SAR

82. All college SARs would require funding to pay for the insolvency practitioner and other associated costs. These costs may be met by the creditors, whether in the form of additional funding, or from the realisation of the assets. In SARs, administrators would have the high level special objective set out in legislation, which may result in

additional costs above and beyond those of a normal administration. This is likely to be the case in an education SAR, for example, because the administrator may need to run the college beyond the statutory 12 month period for an ordinary administration in order to “teach-out” the students. Keeping the college open will incur the usual running costs (salaries etc). It may also delay the realisation of assets, particularly property where the administrator needs to retain the buildings in order to continue to teach the students, or effectively disregard other prospective purchasers if the administrator needs to dispose of a property to a particular purchaser to protect learners.

83. To allow consideration of particular cases where the education administration would create a financial disadvantage for creditors, or in order to fund the administration itself, Government intends to take a power in legislation for the Secretary of State to make grants or loans, issue indemnities or make guarantees where he considers it appropriate to do so. The Secretary of State would be able to use these powers to provide funding on a case-by-case basis, under the terms set out in a funding agreement.

## Ending of a SAR

84. The education administration would end by court order. If the special objective of the SAR has been achieved, the education administrator or Secretary of State would make an application to the court for the SAR to end. If the college was a going concern, that would be the end of the process. If it was a transfer of provision, followed by winding up of the college, the college would then be put into liquidation via court order.

## Replacing the SAR administrator

85. The appointment of the administrator would end once the SAR ends. However, there may also be circumstances where it would be necessary to replace the administrator due to:
  - resignation;
  - loss of qualification; or
  - removal from office by the court, etc.
86. The SAR provisions would mirror insolvency law to deal with these eventualities. If a person ceased to be the education administrator for any reason, they would be discharged from all future liabilities in respect of their actions as administrator.



## 7.4 Other Issues

### Colleges as Charities

87. The governors of colleges, which are exempt charities, have specific duties and the administrator or liquidator would need to be cognisant of the obligations on the governors which affect college assets generally as well as in relation to assets held in specific trust (see section on Assets under Section 33J of the Further and Higher Education Act 1992, below).
88. The education administrator as agent of the college under the special administration regime is subject to the same duties as a charity trustee. If the administrator follows the special objective to protect continuity of provision for learners, this will be consistent with his duties to carry out the purposes of the charity.
89. As in other insolvency procedures, the insolvency office-holder will have duties towards creditors. Property held on specific trusts may not be available to the insolvency practitioner. If there is a surplus in any ordinary or special administration then that surplus must be used for the charitable purposes of the college.
90. Under charity law, the disposal of college assets is allowed if it supports the administration's or liquidation's purpose, and includes the distribution of assets to creditors. However, assets held on specific trusts, rather than as part of the college's corporate property, do not form part of the property available for distribution to the college's creditors. Some colleges hold assets under specific trust deeds which have conditions attached to them; such assets must be dealt with in accordance with the conditions specified.

### Assets held by colleges specified by order under Section 33J of Further and Higher Education Act 1992

91. A specific category of sixth form colleges with underpinning trusts is designated under section 33J of the Further and Higher Education Act 1992 - Under section 33P(4) of the 1992 Act, if such a college subsequently dissolves, any property held by the corporation on trust for the purposes of the relevant sixth form college reverts to the trustees and cannot be transferred to a prescribed body. Our intention is to replicate this provision in the case of insolvency of a sixth form college to which section 33J applies, so that property held on trust by these colleges will be ring-fenced and revert automatically to the trustees, rather than form part of the asset base which will be available to meet the claims of creditors.

### Governors' Liabilities and Duties

92. The charitable status of colleges means that Governors of colleges are also trustees of the charity and, as such, are already subject to important duties set out in charity law, including being responsible for the control and management of their college, as a charity<sup>18</sup>.

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<sup>18</sup> Trustee duties are set out in the Charity Commission guidance 'The Essential Trustee': <https://www.gov.uk/government/publications/the-essential-trustee-what-you-need-to-know-cc3/the-essential-trustee-what-you-need-to-know-what-you-need-to-do>



93. Their duties include:
- Ensuring the charity is carrying out its purposes for the public benefit;
  - Complying with the charity's governing document and the law;
  - Acting in the best interests of the charity;
  - Ensuring the charity is accountable;
  - Managing the charity's resources responsibly; and
  - Acting with reasonable care and skill.
94. Governors as trustees are ultimately responsible for deciding what activities the charity will undertake, what resources it will need, and how it will obtain and use them. Collective decision making is one of the most important parts of the trustee role.
95. As charity trustees, governors have a duty to act with reasonable care and skill. They must act responsibly, reasonably and honestly; should put appropriate procedures and safeguards in place - such as ensuring sufficient information is available before taking a decision, keeping full records of all decisions, and taking appropriate independent advice - and take reasonable steps to ensure that these are followed. Otherwise, they risk making the charity vulnerable to loss and of being in breach of their duty.
96. Trustees can be held personally liable to their charity for any financial loss they cause or help to cause by their wrongful action. This applies to any type of charity whatever its legal form. However, charity law protects trustees who have acted honestly and reasonably from personal liability. Section 145 of the Learning and Skills Act 2000 provides that if a corporation member is found liable in civil proceedings, they have the right to apply to the court for relief from liability where the individual has acted honestly and reasonably.
97. There is no legal protection for trustees of any charity, no matter what their legal form, where they have acted dishonestly, negligently or recklessly.

## Wrongful and Fraudulent Trading

98. In introducing an insolvency regime for FECs and SFCs, Government intends to follow, as far as is practical, the principles of company insolvency. We therefore propose to apply the provisions of the Insolvency Act 1986 that relate to directors' liabilities, to college governors. Most significantly, these include potential liability for wrongful and fraudulent trading, but also related matters such as the remedies for misfeasance. These are important limbs of the corporate insolvency regime which protect creditors against wrongful conduct by the directors of a company (and by others in the case of fraudulent trading). While we recognise that Governors may be concerned at what they see as the introduction of a new burden that carries with it personal liability, for the most part the wrongful and fraudulent trading provisions are consistent with their existing duties as charity trustees, and Governors will already be mindful of not breaching these duties. Indeed, in the event that they were to breach wrongful and fraudulent trading provisions it is likely that they would, through the same conduct, also already be in breach of their duties as charitable trustees.
99. It should be noted that, were the courts to take the view that colleges are "unregistered companies" (paragraph 25), it would mean that governors could already be within the scope of these provisions.

### Fraudulent trading

100. Fraudulent trading is where any business of a company has been carried on with the intention of defrauding creditors, or for any fraudulent purpose. If the Insolvency Act 1986 provisions on fraudulent trading were expressly applied, then on application by the administrator or liquidator of a college, any person who was knowingly party to the fraudulent trading, including a governor, could be held by the court to be liable to make contributions to the college's assets. Fraudulent trading may also lead to criminal liability.

### Wrongful trading

101. Governors may incur liability for wrongful trading in cases where they knew, or should have concluded, that a college had no reasonable prospect of avoiding insolvent administration or liquidation, unless they then take appropriate action to protect creditors. If found liable, on application by an administrator or liquidator, the court may order a governor to make a contribution to the assets of the college.
102. In practice governors would be able substantially to mitigate their risk of wrongful trading liability by acting in line with their duties as charitable trustees; including respecting good practice, following proper process, ensuring appropriate professional advice is available before taking key decisions, and recording the basis of decisions.
103. It is normally but not always the case that the Principal of a college is also a governor of that college. Given their inevitable seniority and Accounting Officer role, we propose that a Principal, who is not a governor, should also be liable for wrongful trading, where they had acted unlawfully. In some cases, particularly in larger colleges, there may be other members of a college's senior management team, such as the Chief Finance Officer, who might have some authority to direct decision making or operate themselves to cause wrongful trading. However, these arrangements may vary significantly across colleges and Chief Finance Officers and other senior managers may not be involved in key decisions by Governing Bodies.

We are therefore minded that these individuals should not be liable for wrongful trading unless (as with any individual) they are also a governor or are in practice acting as if they were a governor. Anyone, regardless of their official position, who acted as a 'de facto' governor and outside their normal role, could be liable.

104. We propose that Clerks of colleges should be treated comparably to company secretaries and so would not be liable for wrongful trading, unless, as set out above, they were acting as a 'de facto' governor. Clerks should be mindful of their normal duty to bring to the attention of the Board of Governors a situation within the college that is 'materially adverse'.
105. Other special administration regimes apply the provisions of the disqualification regime under the Company Directors Disqualification Act 1986 (CDDA) to relevant individuals within specified organisations. We are considering whether we should adopt a similar approach in relation to governors of colleges who are found liable of fraudulent or wrongful trading. This would mean that a college governor (or anyone acting as a 'de facto' governor) found liable, could be disqualified under the CDDA in the same way as a company director, and that any governor disqualified under the CDDA would also be disqualified from acting in similar positions, including as a company director and a trustee of a charity.

**Question 6: Do you have any views on our proposals in relation to directors' and governors' liabilities?**

**Application of Insolvency Law on the Avoidance of Certain Earlier Transactions on Winding-up or Administration**

106. An overriding principle of insolvency proceedings is that once commenced, all creditors are treated equally and fairly, with some well-defined exceptions such as the protection of security. The principle of avoidance of transactions is a way of extending that principle of equality back to before the commencement of those insolvency proceedings.
107. The insolvency law applying to companies therefore enables some transactions to be avoided (that is, set aside) by a liquidator or administrator where those transactions breach the principle of equal and fair treatment. The effect of this is to seek to put creditors back in the position they would have been in if the transaction had not taken place. Among the transactions which may be avoided are:
  - Transactions at an under value, where a company has sold assets for less than their value or bought assets for more than their value in the run up to insolvency
  - Preferences, where a company seeks to improve the position of a particular creditor, usually by paying them ahead of other creditors.
108. The application of law on avoidable transactions should help to clarify the legal position and to avoid gaps in the insolvency regime which could otherwise be exploited in ways which are unfair to the college's creditors as a whole.

**Question 7: Do you agree that, as a matter of general principle, the insolvency law applying to companies on the avoidance of transactions should apply to colleges? Please explain your answer.**

### **Fixed and floating charges (provisions of Part 3 of the Insolvency Act 1986)**

109. We have considered the application of Part 3 of the Insolvency Act 1986 (receivership) to colleges. The general consensus is that further education colleges and sixth form colleges do not have the power to create floating charges and we do not propose to change that; however we do propose to apply the provisions of Part 3 of the Insolvency Act 1986 that deal with fixed charges.

**Question 8: Do you agree that only provisions of Part 3 of the Insolvency Act 1986 that deal with fixed charges, should apply to colleges? Please explain your answer.**

### **Pensions**

110. We recognise that any change to the insolvency position of colleges may have implications for pension fund contributions and liabilities, particularly in relation to the Local Government Pension Scheme (LGPS). The Teachers' Pension Scheme is an unfunded scheme paid out of general taxation, not an underlying investment fund.
111. The LGPS is a defined benefit scheme with benefits payable from the scheme based on the amount of money paid in, the returns achieved on that investment and the market conditions at force at the time that the benefits become payable. All colleges carry a liability with respect to LGPS; and this is being revalued during 2016. The college's liability crystallises (and becomes payable) if they cease to have employees making contributions to the fund. This could happen in special administration for both a college closure and a college merger scenario. However, a college merger does not usually trigger a crystallisation (even where the colleges are in different LGPS funds) as there is an established process for the negotiation to transfer members and liabilities between funds.
112. If the college either transferred to another employer outside of the scheme or was to ultimately be liquidated and wound up, then the pension deficit would crystallise. In this event (when an LGPS employer loses its last active member it then becomes an exiting employer and an exit payment is calculated) the employees' accrued and deferred pensions benefits would be protected. Any pension deficit to the fund would have to be met through a claim against the assets of the exiting college as an unsecured creditor, or through an increase in contributions from the remaining scheme members (where a claim against the assets was not sufficient to meet the deficit).

## Other related issues

### Local Devolution

113. As part of a wider government policy on English Devolution, the Government has set a clear ambition to support local areas in taking a leading role over funding and commissioning provision from a skills system that meets local economic priorities and the needs of local people. The devolution of the Adult Education Budget (AEB) from 2018/19 onwards has already been included in nine mayoral devolution deals negotiated with combined authorities in England, with an ambition to agree more. Proposals for a new insolvency regime for the college sector in England take this evolving policy context into account.

### Higher Education (HE)

114. Officials are working closely to ensure that proposals on student protection and public interest in both are where appropriate properly aligned, and also take into account the differences in the provider landscape and student profile.

### Academisation

115. The new insolvency regime would apply to sixth form colleges as well as other further education colleges. However, as part of the Area Review process, sixth form colleges are able to apply to become 16-19 academies. Any sixth form college which becomes an academy will cease to be part of the FE sector and would not be covered by the proposed new insolvency arrangements. Instead, they will be subject to the DfE financial monitoring and management arrangements which apply to academies more generally.

**Question 9: Do you have any other comments on the proposals set out in the consultation document?**

## 7.5 Summary of Consultation Questions

**Question 1: Do you agree that only the SAR element of this regime should be applied only to Designated Institutions that are companies? Please give reasons for your answer.**

**Question 2: Do you think any of the insolvency measures summarised in our proposals (Company Voluntary Arrangement, ordinary administration, compulsory liquidation and creditors' voluntary liquidation) should be available in the event of college insolvency as well as a Special Administration Regime? Please explain your answers.**

**Question 3: Does the proposed special objective sufficiently reflect the needs of learners and creditors? Please explain your answer.**

**Question 4: Do you have any comments on our proposals for SAR initiation?**

**Question 5: What issues, if any, would you envisage if transfer of provision or assets/liabilities were required?**

**Question 6: Do you have any views on our proposals in relation to directors' and governors' liabilities?**

**Question 7: Do you agree that, as a matter of general principle, the insolvency law applying to companies on the avoidance of transactions should apply to colleges? Please explain your answer.**

**Question 8: Do you agree that only provisions of Part 3 of the Insolvency Act 1986 that deal with fixed charges should apply to colleges? Please explain your answer.**

**Question 9: Do you have any other comments on the proposals set out in the consultation document?**

## 8. What happens next?

This consultation will run for four weeks, with a closing date of 05 August 2016. The Government will consider the consultation responses and publish a response in due course, setting out how it intends to proceed in the light of those responses. The Government response will be published on the BIS pages of [www.gov.uk](http://www.gov.uk).

## 9. Economic Assessment of the Insolvency Proposals

### Background

116. Further education (FE) and sixth form (SF) colleges have faced a number of financial challenges over recent years. The college sector faces increased competition for 16-19 year-old provision with more academies, university technical colleges and free schools opening sixth forms. They also face a decreasing demand because of the declining 16-19 cohort. While many colleges have responded swiftly to those changes and a majority are currently rated as having at least satisfactory financial health, some colleges have been slow to adapt and financial difficulties have arisen.
117. Currently, FE colleges in financial difficulty can seek Exceptional Financial Support (EFS)<sup>19</sup> where the college is unable to secure financial support from commercial lenders and is necessary to protect learners. Since such case-by-case interventions are not sufficient to address the growing structural problem within the sector, the Government established the Area Review process with the objective of creating a more financially sustainable sector and a stronger educational offer through a locally driven process. Our expectation is that the Reviews will lead to fewer, larger and more specialised colleges, as well as more collaboration between institutions. This will normally be achieved through mergers and in some cases closures.
118. The legal position on winding up failing colleges remains uncertain: the Further and Higher Education Act 1992 allows for voluntary dissolution of a college and for its assets and liabilities to be transferred to another willing provider. Colleges are statutory corporations and there is no express provision for a college to dissolve if insolvent. Furthermore, there is no implied obligation for the Secretary of States either to prevent the insolvency of a college or to meet its liabilities upon insolvency. The combination of barriers to exit and distortions in the market where commercial decisions are not directly linked to funding outcomes means that the further education market is not as effective as it could be.

### Economic Rationale for Intervention

119. The college sector is dependent on government funding – with 90% of FE colleges and 95% of SF Colleges relying on government funding for more than 80% of their income<sup>20</sup>. Less than effective responses to changes in profile of government funding, coupled with increased competition for 16-19 year-olds in the context of a shrinking cohort have contributed to deterioration in the financial health of many colleges. Furthermore, at a minority of colleges there is a potential problem of ‘moral hazard’ – with expectations that government will intervene in the case of financial difficulties, weakening incentives for good financial management and for learning provision to respond to local economic needs and government priorities. This has potentially contributed further to the declining financial health of the sector and distorts the link between the commercial decisions taken by college and their funding base.

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<sup>19</sup> Exceptional Financial Support applies to further education colleges only.

<sup>20</sup> Source: Analysis of College Accounts Data



120. The Area Reviews will assess the structural changes required to improve local provision, including mergers or closure of colleges. In practice, under current law, restructuring funding may be needed to avoid disorderly closures. Although the Area Reviews are intended to leave the college sector in a more stable position, we cannot assume colleges will never become insolvent in the future. We therefore need to develop a means by which failing colleges can close in as orderly a way as possible, with rights for creditors comparable to companies, as well as measures in place to protect learners. This should also aim to send a signal to the sector that any government funding will be targeted on protecting learners rather than ‘propping up’ colleges in financial difficulties i.e. by removing the moral hazard aspect.

Therefore, the broad objectives are to:

- Establish an orderly process which provides rights for creditors comparable with other relevant UK insolvency regimes;
- Protect the interests of learners by promoting continuity of provision;
- Retain independence and freedoms of colleges whilst removing or mitigating any expectation of additional exceptional public funding;
- Support local and national education and training needs;
- In cases where it is feasible, facilitation of the rescue of the FEC/SFC as a going concern, including access to new financing;
- Maintaining and maximising the value of the assets of the FEC/SFC; and
- Creating a legislative context in which commercial lenders will continue to lend to colleges on appropriate terms.

### Options Appraisal

121. It is not the role of this economic assessment to analyse the nuances of different legal options to achieve the objectives above. Instead, it considers two broad options – 1) doing nothing and 2) the proposed suite of insolvency procedures set out earlier in this document, in addition to a SAR. The nature of the costs and benefits means their quantification and monetisation would be highly speculative, so we focus on a description of the respective costs and benefits under each option.

**Do Nothing:** This would allow colleges to continue whilst financially unstable – until they reach insolvency. If they do become insolvent, the process for dealing with their debts would be uncertain and would involve potentially lengthy and costly litigation. This may be followed by a court-appointed liquidator (appointed on behalf of college creditor(s)) taking action against the college which could result in its closure, and thus a disruption of provision for learners (and an associated detriment and loss of economic value added).

**Implement a full suite of Insolvency Measures with a Special Administration Regime (SAR):** Traditionally, SARs are used to protect an over-riding public policy objective such as continuity in the provision of an essential service in the public interest. There are a number of SARs operating across many sectors, such as energy and water. In this case, an

administrator would be appointed and be responsible for developing proposals for either the rescue or transfer of the college. Where a rescue was not viable, they would have to take into account the protection of learners, as well as their obligations to creditors. The essence would be that the administrator would keep the college operating for long enough to enable learners to complete their education or training, or if that was not possible, to transfer learners to another provider, after which the college could be wound up.

122. The analysis below assesses the costs and benefits of implementing the full suite of insolvency measures set out earlier in this document, in conjunction with a SAR – **relative to the ‘do nothing’ option (i.e. option 1).**

## Option 2: A full suite of Insolvency Measures with a SAR

### Costs

123. This option would be complex and challenging to set up, so establishing it would entail certain legal and policy development costs.
124. When implemented, it would see a court-appointed administrator (licenced Insolvency Practitioner) come in and become the head of the institution in place of the governors. This would entail a number of costs:

**Salary Costs:** As the administrator may have little or no experience in running a college, an individual with such experience would be required. This would incur costs as the college would effectively have required two people to run it i.e. an administrator and a college practitioner.

**Confusion over Process:** There is likely to be some initial confusion over the process of closing/merging a college until the first or second case is fully conducted (a feature of SARs in other sectors); although this needs to be set against the confusion, albeit different in nature, of disorderly closures under option 1.

**Continuing Learner Provision Costs:** There could also be additional costs to HMG from maintaining provision for learners if a college cannot source funding from elsewhere; again this needs to be set against the economic benefits outlined in point 1 of the benefits below).

### Benefits

**Protection of Learners:** Relative to option 1, this would allow colleges to continue provision for learners whilst the administrator finds a feasible solution for the future of the college, whether it be a merger or a transfer of learners and closure, thus allowing the economic benefits of learning to be realised. The average government-funded post-19 FE learner generates net economic benefits of £34,000 over their working life, compared with not going into further education. Therefore, to the extent that this option allows individuals to complete their learning – or gives them the confidence to invest in learning at all – then this will generate economic benefits for the local and national economy.

**Future Planning:** This option will allow for greater planning, and greater certainty, for those involved – such as students, teachers. For example, if an administrator develops a proposal for either a transfer or college closure, they will also be responsible for finding alternative provision for learners. This will give learners more confidence to invest in learning and give college staff greater certainty on their employment once a proposal has been developed.

**Legal Clarity:** There will be a greater legal clarity surrounding the future as the administration will need to consider learner protection and service provision when proposing a plan for the college. This option also potentially reduces future legal costs for colleges and creditors e.g. of counsel advice, advice from insolvency practitioners and potentially costly court cases, relative to Option 1.

**Maintaining Investors' Confidence:** Relative to option 1, this should help to ensure a continued flow of capital to the sector at relatively low cost. The confidence of banks and other investors is maintained through clarity of process where a college has a solvency problem, and allows them to conduct more accurate risk assessments and to have clarity on the process in the event of insolvency.

**Maximising Asset Value:** The more orderly nature of any closures, and any asset sales, should help to ensure that their value is maximised.

**Targeted Funding:** A funding arrangement will need to be provided to ensure that the SAR can be executed and learner provision is protected. This is beneficial as it represents focused and time-limited HMG funding, which protects taxpayers from ongoing and potentially uneconomic funding of colleges.

**Signal to Colleges:** Establishing the insolvency measures and the SAR, and thus having a clear and credible process for colleges in financial difficulties, would aim to reinforce the message that they are independent organisations, and that government will not act as a lender of last resort, or prop them up, in the case of financial difficulties. This should overcome the 'moral hazard' problem described previously, providing stronger incentives for disciplined financial management.

## Risks

125. There are a number of risks associated with implementing this option:

- The presentational risks in the case of closures (although this is also an issue under option 1). Closing colleges is likely to be poorly received in the affected areas – so an effective stakeholder management plan would have to be implemented.
- The complex legal change that is required with the implementation of this option. As there is uncertainty surrounding how the actual process will happen, it will need to be presented to stakeholders in a clear manner so they fully understand this process. However, once the initial cases are conducted, this should create clarity in how the process should be carried out (again this is also an issue under the 'Do Nothing' option).
- Potential impacts on the availability of funding for colleges, as lenders build risk into their calculations on individual colleges.

## Recommendation

126. On the basis of the costs and benefits outlined above, option 2 is the preferred option i.e. to proceed with a full suite of insolvency procedures with a Special Administration Regime (SAR) for colleges. This will best meet the policy objectives outlined above by targeting the protection of learners in the event of college insolvency, providing legal clarity and an orderly legal mechanism, and by maintaining the autonomy of colleges while removing the moral hazard aspect; and will do so in a cost effective manner.
127. Although it is complex and challenging to deliver, the proposed suite of insolvency measures in conjunction with the SAR provides significant flexibility for colleges to identify solutions to their solvency issues. It provides the clarity for creditors and protects learners through the targeted funding of colleges. It also protects taxpayers by establishing an orderly process which focuses public funding on a time-limited basis to maximise value added.

## Annex 1: Consultation Principles

128. The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf>

### Comments or Complaints on the Conduct of this Consultation

129. If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Angela Rabess  
BIS Consultation Co-ordinator  
1 Victoria Street  
London  
SW1H 0ET  
Tel: 020 7215 1661  
Email: [angela.rabess@bis.gsi.gov.uk](mailto:angela.rabess@bis.gsi.gov.uk)

130. However if you wish to comment on the specific policy proposals you should contact the policy lead (see section on 'Help with queries').

## **Annex 2: List of Individuals/Organisations Consulted**

131. Officials have undergone a period of pre-consultation to discuss key elements of these proposals with a number of stakeholders including The Association of Colleges, 157 Group and The Sixth Form Colleges Association, as well as representatives of a number of lenders, trade unions, insolvency practitioners and lawyers.
132. We would welcome suggestions of others who may wish to be involved in this consultation process and are happy for you to draw their attention to this document.

## Annex 3: Glossary of Terms

Terms	Explanation
Administration	Insolvency procedure that may be used to rescue a company (college) as a going concern or produce a better result than an immediate winding-up
Administrator	Insolvency practitioner appointed by the court or directly by a floating charge-holder or college governors
Exempt Charity	An institution established for charitable purposes exempt from registration and regulation by the Charity Commission. They have a principal regulator instead; FECs are regulated by the SoS for Business, Innovation & Skills and SFCs by SoS Education.
College administrator	An insolvency practitioner appointed to take control of the affairs, business and property of a failed college who is obliged to secure the continuity of education and training services in line with the special administration objective
College governor	As members of the college governing bodies, governors collectively set the college's strategic direction, hold the Principal to account for a college's performance and ensure that the college's budget is properly managed
Company Voluntary Arrangement	Procedure where college comes to a binding arrangement with its creditors for the settlement of debts
Compulsory Liquidation	Insolvency procedure commenced by court order (winding-up order) usually after the filling of a petition by a creditor
Creditor	A person owed money

Terms	Explanation
Further and Higher Education Act 1992	Primary legislation which made changes in the funding and administration of further education and higher education within England and Wales, including removing FECs from local government control
Further Education Corporation (FEC)/ Sixth Form Corporation (SFC)	Further education and sixth form corporations are statutory corporations which provide education and training to learners aged 14 and over in England
Insolvency	<p>Cash Flow Insolvency: the state of being unable to pay the money owed, by a person or company, on time</p> <p>Balance Sheet Insolvency: where liabilities of a person or company are greater than their assets</p>
Insolvency Practitioner	A person (generally an accountant or solicitor) qualified and authorised to act as an insolvency office-holder, for example acting as an administrator or liquidator
Insolvency Act 1986 (IA86)	Primary legislation governing corporate insolvency of companies in Great Britain and individuals in England and Wales.
Liquidation (winding-up)	Process in which assets are realised (e.g. sold) and distributed to creditors. A business will usually close down when a company (college) goes into liquidation. Winding up may be commenced by court order or voluntarily by company members (in the case of colleges this would be by governors)
Liquidator	A person or insolvency practitioner, appointed to take control of a failed college and realise assets for the benefit of creditors



Terms	Explanation
Preferential creditor	A class of creditor, specified in law, which is paid before the claims of any floating charge-holders and ordinary unsecured creditors. The main categories of preferential debts are certain amounts due to employees and contributors to occupational pension schemes.
Restructuring Facility	Financial support available to colleges to help implement the recommendations of the Area Reviews
Special administration regime	Alternative insolvency arrangements to the administration procedures set out in the IA86. Special administration regimes are based on the process of administration, but with modifications aimed, for example to secure the continuity of essential public service if a supplier fails
Secured creditor	A creditor holding security, for example a fixed or floating charge, over assets in respect of monies owed.
Unsecured creditor	Creditors who do not hold security in respect of monies owed to them. Claims may be either preferential or ordinary
Voluntary Liquidation	Winding up commenced by a resolution of a college's governors where the college is insolvent

## Annex 4: Equalities Analysis of Developing an Insolvency Regime for the Sector

### Equalities Analysis

133. The Department of Business, Innovation and Skills and Department for Education are required to comply with the public sector duty (PSED) set out in the Equality Act 2010 (“the Act”). The PSED requires the Minister to have due regard to the need to advance equality of opportunity, eliminate unlawful discrimination and foster good relations between those with and without certain protected characteristics. This due regard is taken to eliminate unlawful discrimination and to tackle prejudice and promote understanding.
134. The protected characteristics are:
1. Age;
  2. Disability;
  3. Gender Reassignment;
  4. Marriage and Civil Partnership;
  5. Pregnancy and Maternity
  6. Sex;
  7. Race;
  8. Religion or belief; and
  9. Sexual Orientation
135. One of the objectives of the insolvency measures and the SAR is to protect the interests of learners by ensuring continuity of provision. We do not know exactly which colleges would be affected both with and without these measures, so we need to assess data on the learner population as a whole.
136. With regards to further education and sixth form colleges, we expect that disorderly closures (which would happen without the proposals included in this document) would result in a loss of provision and this would disproportionately affect learners from the following groups. Therefore, the measures put forward here would protect these groups to a greater extent:
- Ethnic minority backgrounds: 21% of learners in FE/SFCs are from minority ethnic background vs. 14.6% in the overall population in England
  - Young learners: 38% of learners in FE/SF colleges are aged 16-18 vs. 4% in the overall population in England.
137. Data shows that the proportion of women studying in FE/SF colleges (51%) is very similar to the proportion of women in the overall population in England (50%). We have therefore found no evidence to suggest that disorderly closures would disproportionately affect men or women.
138. We consider the likely impact of the proposals based on the protected characteristics to be:

1. Age – as mentioned above, 38% of FE learners are 16-18 years old, so the proposed regime will offer greater protections that they are afforded under the counterfactual i.e. the disorderly closure of colleges;
  2. Disability – there is no evidence to suggest that there would be disproportionate effects on people with disabilities;
  3. Gender Reassignment – there is no evidence to suggest that there would be disproportionate effects on the grounds of gender reassignment;
  4. Marriage and Civil Partnership – there is no evidence to suggest that there would be disproportionate effects on people because of their marital status;
  5. Pregnancy and maternity – there is no evidence to suggest that there would be disproportionate effects on pregnant women;
  6. Sex - We have found no evidence to suggest that disorderly closures would disproportionately affect this males or females.
  7. Race – a higher proportion of those from ethnic minority backgrounds attend FE college and they will offer greater protections that they are afforded under the counterfactual i.e. the disorderly closure of colleges Religion or belief;
  8. Religion or belief; and
  9. Sexual Orientation - there is no evidence to suggest that there would be disproportionate effects on people because of their sexual orientation
139. As mentioned above, the policy is expected to beneficially impact learners at colleges that go insolvent, including those with protected characteristics. As some groups with protected characteristics comprise a higher proportion of learners relative to the general population, this policy could have some positive equality impacts.

### Family test

140. We have reviewed the Family Test and we do not think this will have significant impacts on families within the UK; this measure should benefit learners that are affected by colleges that enter insolvency by ensuring continuity of provision.

## Annex 5: Consultation on Developing an Insolvency Regime for the Sector Response Form

The consultation is available at: <https://www.gov.uk/government/consultations/developing-an-insolvency-regime-for-the-further-education-and-sixth-form-sector>

The closing date for responses is 05/08/2016.

Please return completed forms to:

Benjamin Dance  
Department of Business, Innovation and Skills  
Vocational Education Directorate  
Orchard 1  
2nd Floor  
1 Victoria Street  
London  
SW1H 0ET  
Tel: 0207 215 4839  
Email: [FEconsultation@bis.gsi.gov.uk](mailto:FEconsultation@bis.gsi.gov.uk)

Please be aware that we intend to publish all responses to this consultation.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes. Please see page 8 of the consultation for further information.

If you want information, including personal data, that you provide to be treated in confidence, please explain to us what information you would like to be treated as confidential and why you regard the information as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

I want my response to be treated as confidential

Comments:

## Questions

Name:

Organisation (if applicable):

Address:

	<b>Respondent type</b>
<input type="checkbox"/>	Business representative organisation/trade body
<input type="checkbox"/>	Central government
<input type="checkbox"/>	Charity or social enterprise
<input type="checkbox"/>	Individual
<input type="checkbox"/>	Large business (over 250 staff)
<input type="checkbox"/>	Legal representative
<input type="checkbox"/>	Local government
<input type="checkbox"/>	Medium business (50 to 250 staff)
<input type="checkbox"/>	Micro business (up to 9 staff)
<input type="checkbox"/>	Small business (10 to 49 staff)
<input type="checkbox"/>	Trade union or staff association
<input type="checkbox"/>	Other (please describe)

**Question 1: Do you agree that only the SAR element of this regime should be applied only to Designated Institutions that are companies? Please give reasons for your answer.**

Comments:

**Question 2: Do you think any of the insolvency measures summarised in our proposals (Company Voluntary Arrangement, ordinary administration, compulsory liquidation and creditors' voluntary liquidation) should be available in the event of college insolvency as well as a Special Administration Regime? Please explain your answers.**

Comments:

**Question 3: Does the proposed special objective sufficiently reflect the needs of learners and creditors? Please explain your answer.**

Comments:

**Question 4: Do you have any comments on our proposals for SAR initiation?**

Comments:

**Question 5: What issues, if any, would you envisage in the event transfer of provision or assets/liabilities were required?**

Comments:

**Question 6: Do you have any views on our proposals in relation to directors' and governors' liabilities?**

Comments:

**Question 7: Do you agree that, as a matter of general principle, the insolvency law applying to companies on the avoidance of transactions should apply to colleges? Please explain your answer.**

Comments:

**Question 8: Do you agree that only provisions of Part 3 of the Insolvency Act 1986 that deal with fixed charges should apply to colleges? Please explain your answer.**

Comments:

**Question 9: Do you have any other comments on the proposals set out in the consultation document?**

Comments:

**Do you have any other comments that might aid the consultation process as a whole?**

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

Yes

No



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