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Global trends in the treatment of local public entities in distress: A principled approach

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Abstract

This article presents the findings of a global study on the treatment of local public entities in distress conducted in 20 jurisdictions across the world. It sets out to detail and analyses how different national insolvency law systems treat local public entities in distress. The main purpose of this study is to provide recommendations for a harmonised and principled treatment of these entities. The key priority of the recommendations proposed in the study is to ensure the continuity of essential public services without necessarily deviating from the established insolvency principles of collectivity and equality of treatment among creditors.

1 | INTRODUCTION

This article presents the findings of a global study on the treatment of local public entities in distress conducted in 20 jurisdictions[1] across the world. It sets out to detail and analyses how different national insolvency[2] law systems treat local public entities in distress. The financial distress of local public entities raises unique issues. Providing a definition of 'local public entity'

is a challenging task. Local entities differ in nature and size, with some providing a wide range of services for large numbers of people in urban environments, while others have fewer duties and rely on less generous budgets to serve a smaller population. Many states leave this concept undefined. In some instances, local, regional and federal levels within the same state provide contradictory definitions.

For the purposes of this study, a 'local public entity' is a public authority or entity partially or totally funded by tax levies. This entity provides public services, namely essential services with a collective or social dimension (such as transport, education, social housing and care, hospitals, and utility services), not necessarily or not always at market price, to local communities. If any such entity faces financial distress, special rules should be put in place to ensure the continued provision of essential services to local communities. This specific objective is unique to the treatment of LPEs in distress. The need to ensure the provision of essential services sets local public entities apart from the general principles applicable to corporate entities, which are broadly designed to maximise the return to the debtor's creditors.

As part of our study, we distinguished between basic and hybrid local public entities. Examples of 'basic' local public entities include municipalities, cities, districts, councils, provinces and other political sub-divisions. Alongside these basic local public entities, there are 'hybrid' local public entities. These are publicly or privately owned entities (including corporations) that carry out essential services and/or are responsible for the production or distribution of essential goods at a local (territorial or regional) level. These entities, which may be incorporated under private or public law, can be considered hybrid entities only if two conditions are met. Firstly, they need to carry out a public service and mission such as those mentioned above. Secondly, another local authority or municipality must ultimately be responsible, legally or politically, for all or part of their debts.

It follows that, for the purpose of our study, we excluded the notion of 'local public entities':

- state or locally owned enterprises operating at the national level (except for very small states);
- banks or other financial institutions, unless their fundamental goal revolves around the development of collective projects and entrepreneurial activities at a local level and the local authority or municipality is ultimately responsible, legally or politically, for all or part of their debts and
- state or locally owned enterprises which are not carrying out any collective, social or public function, but are simply operating in the market in competition with other private enterprises.

Insolvency practitioners tend to know little about how local public entities in financial distress are managed. Globally, insolvency laws pertaining to local public entities are heavily influenced by local traditions, cultures and historic developments. The treatment of local public entities in distress is a significantly under-researched area of insolvency and public law, particularly outside the USA. This is certainly not due to the marginal relevance of this phenomenon, as an increasing number of such entities find themselves unable to meet their contractual obligations. More and more jurisdictions are evolving and reforming their legal responses to meet the practical and conceptual difficulties arising from the treatment of insolvent or distressed local public entities. There are no easy solutions, it would appear. Additionally, the financial collapse of local entities may trigger a domino effect on the private sector (as many suppliers

rely on payments from local entities to meet their obligations), as well as on local, regional, and national communities.

In this article, we draw some general observations from the country reports generated by our study, and we comment on some of the main challenges faced by the laws considered under study. Our study assesses the legal frameworks for dealing with distressed local public entities. We do not comment on the frequency with which some of the instruments are used on a local or global/comparative basis. There are elements in our approach in this article that might loosely be classed within the functional method[3] often adopted in comparative law analysis. We draw from the evidence provided by the country reports to assess whether, overall, the national laws promote a principled approach to the treatment of local public entities in distress.

Of course, the functional method is not without criticism.[4] However, for practitioners and policy makers, it remains a useful (albeit possibly narrow) method for looking at discrete aspects of good or poor practice while avoiding over-generalisation.[5] Additionally, some of the usual critiques of the functional method are ill-suited when applied to this work. As evidenced below, the study adopts a solid theoretical framework that clearly discloses its 'inputs' and foundational principles. On this point, the distinction between basic and hybrid local public entities emerged from the study itself and from discussions with the commentators. It was not imposed by the leading investigators of this project.

The study is certainly interested in how the law works in practice, as this is a significant portion of each national analysis. The study also acknowledges the role of local legal cultures and contexts, as it explicitly investigates the role that some external factors (such as politics) play in creating and operating the legal framework for the treatment of local entities in distress. Finally, the study is not Western-centred, as it adopts a global approach to the investigation of the treatment of local public entities in distress.

One of the most common reproaches to functionalism is that such a method assumes that the law always serves a function. In the area of our study, it is argued that the law does indeed serve the purpose of reducing or at least controlling political interferences and risks. The law seeks to bring a degree of legal certainty and predictability for creditors and investors, thus promoting investments in a badly under-funded sector.[6] The functional method adopted in this study could be described as 'problem-solving functionalism'.[7] This study considers both differences and similarities among legal approaches, and the ensuing recommendations are at a general level. The study flags some aspects the law should deal with, and the most common issues that may arise. It is not prescriptive as to the exact solutions to be adopted, as it recognises that different legal backgrounds may approach similar problems in unique manners.

This comparative study, however, is not simply about describing the treatment of these entities. It is also first and foremost about the principles that should govern their treatment. One of the main research questions of this study is if and to what extent the regulation of local public entities in distress should follow the same trends observed with reference to business rescue and liquidation. These trends could be described as progressive but substantially limited mitigation of the principles of collectivity and equality of treatment among creditors to achieve communitarian[8] and substantively fair[9] outcomes. These purposes are the protection of vulnerable[10] and non-adjusting creditors in liquidation procedures and rewarding the contribution of new value in restructuring procedures.

As a result, Section 2 of this article engages in the normative criticism of the purposes underpinning the treatment of local public entities in distress. This critique is based on a revised communitarian framework influenced by Rawls, Finch and Radin's social justice concept of fairness.[11] For these purposes, fairness is understood as a substantive and procedural

concept.[12] It is submitted that procedural fairness is the propensity to rely on replicable and transparent procedures to deal with the interests of different parties in procedures involving local public entities in distress. Substantive fairness is the propensity of the system to deviate from 'horizontal equity'[13] under the law (for instance, by means of preferential treatment for certain categories of creditors) or when adjudicating disputes between parties with conflicting interests in an insolvency process. An insolvency process is understood as procedurally and substantively fair if it considers issues of justice and respects the interests of affected parties by allowing such parties not simply access to, but also respect in the decision-making process. Essential services are 'human services', as they are strictly linked to the dignity of human beings and their aspiration to conduct a dignified life. Substantial fairness plays a more prominent role in this context rather than in contractual disputes as dignitarian issues (such as access to essential services) are comparatively more frequent than in cases of corporate rescues or liquidations.

This study is significant for at least two reasons. First, it is the first project to map in detail and to comparatively analyse the legal frameworks on the treatment of local public entities in distress in a variety of jurisdictions and legal traditions. The philosophy behind this project is that lessons could be learnt from developing and developed, small and large countries alike. For instance, we believe that one of the most advanced, principled, and effective statutory frameworks for dealing with local public entities in distress is the South African one (at least on paper, as South African municipalities have been afflicted by financial problems for many years),[14] despite the fact that its corporate framework is rarely set as an example in international fora.

Second, this is the first project to examine the treatment of distressed local public entities on a global scale, and the first to attempt to articulate unifying principles and standards for the laws and regulations governing the financial distress of these entities. This project provides guidance on the implementation of principled approaches to deviate from the fundamental principles of collectivity and equal treatment of creditors in insolvency while ensuring the substantive fairness and predictability of the framework.

The normative analysis (Section 2) developed in this paper is followed by a discussion of the comparative findings collected in our study (Section 3). The article concludes with a series of principled recommendations for regulatory reform (Section 4). Principles should be implemented with a view to the local conditions. These differ from country to country. Therefore, the present paper does not advocate for one-size-fits-all solutions, but rather for general recommendations to approach domestic reforms in the area in a principled manner.

2 | COLLECTIVITY, *PARI PASSU* AND PRINCIPLES OF FAIRNESS

Legal rights—such as contractual rights, property rights, rights in equity, and so on—really matter when there is a contest among different people claiming rights to the same assets, and when these assets are insufficient to meet these claims. This situation gives rise to what has been described as the 'common pool problem'.[15] In legal terms, the common pool problem has been defined as the problem that arises when individuals' self-interested actions fail to achieve a socially optimal result.[16] This is the context in which insolvency law operates.[17]

Insolvency law is a *collectivised* debt collection device.[18] A proceeding is collective under the law not simply because all creditors take part in it, but also because their relative

entitlements against the debtor are not disregarded for the advantage of equally or lower-ranking creditors.[19] In approaching our research, we noted that the absence of a uniform regime to regulate insolvent local public entities and the peculiar position of some of the claimants may affect the importance of the principle of collectivity in the insolvency of local public entities.

The notion of collectivity is strictly linked with the concept of equality. Under the latter concept, the debtor's assets are administered, and creditors' claims are processed without any regard to the chronological order in which they were acquired or created (*par est condicio omnium creditorum*). The *pari passu* principle is one of the most fundamental principles of corporate insolvency law.[20] It holds that unsecured creditors shall share rateably in the assets of the insolvent company that is available for residual distribution. The *pari passu* principle ensures a rateable distribution of the proceeds generated from the sale of the debtor's assets among a company's general, unsecured creditors. It operates whenever there is a distribution, even in those procedures aimed at rescuing companies.

Collectivity and equality have been hailed as mechanisms to promote procedural fairness.[21] In the corporate insolvency context, a procedurally fair interpretation of the collectivity and equality principles results in the promotion of legal predictability against alternative normative approaches, including the communitarian argument for distributional fairness. Communitarian scholars argue for a shift in the normative approach to corporate insolvency designed to keep companies operating and protect vulnerable players.[22]

It is well known that in most business insolvency cases, unsecured creditors receive no distribution. As a result, communitarians argue that insolvency procedures should become mechanisms to reorganise the capital structure and not to redistribute assets.[23] In many countries around the world, procedurally fair, collective, and egalitarian liquidation-oriented procedures have been complemented by more flexible mechanisms, designed to rescue distressed yet viable businesses and to prioritise the treatment of selected (categories of) creditors. These preferential treatments apply alongside the contractual priorities bargained for by the parties in solvent times, for instance by means of secured claims or by introducing clauses in contracts that produce similar effects.[24] However, it is argued that these deviations should be principled, that is, part of a framework designed to promote 'substantive fairness'.

Substantive fairness is achieved when deviations weigh the economic interests of a broad range of different constituents, including the community and society at large.[25] In contrast to the creditor wealth maximisation approach, which advocates the promotion of individual rights, the communitarian approach promotes value redistribution so that in the event of corporate insolvency, high-priority claimants may give way to others, including the community and society at large, in sharing the value of an insolvent company.[26]

In restructuring procedures, substantive fairness is achieved by prioritising the beneficiaries' contribution to the restructured entity without unduly affecting the position of vulnerable claimants. Substantive fairness is achieved when deviations from collectivity and equality of treatment among creditors protect the vulnerable position of certain non-adjusting creditors. In general, substantive fairness is achieved by making relief that is *legally* available *actually* available.[27]

Local public entities are not run for profit in the same way as businesses. Where value maximisation is the predominant principle in corporate insolvency scenarios—especially in liquidation procedures—the treatment of local entities in distress may require deeper deviations from this proceduralist attitude in order to ensure the continued provision of public services in the public entity context. As a result, some of the value-maximising objections to the

implementation of communitarian goals may lack persuasiveness when applied to the treatment of local public entities in distress. It could, therefore, be argued that a principled approach to the treatment of local public entities in distress should allow deviations from the procedurally fair concepts of collectivity and equality of treatment designed to:

- protect the vulnerable position of certain non-adjusting creditors in both liquidation and restructuring-like procedures and
- reward the beneficiary's contribution to the restructured entity in restructuring-like procedures.

Several reasons suggest that the selective, more communitarian treatment of creditors should not necessarily take place in all the restructurings involving local public entities. For instance, in most of these procedures, the 'common pool' problem may only be apparent. Local public entities can often mitigate cash-flow and balance-sheet issues through a variety of mechanisms, including increased support from central or regional authorities, and higher revenues in the form of direct or indirect tax levies.

However, proceedings involving local public entities in distress affect a larger number of non-adjusting and vulnerable stakeholders than most corresponding liquidation or restructuring business procedures. It is uncommon for business liquidation or restructuring procedures to require detailed considerations of the interests of stakeholders that are not in the debtor's books. Cases such as Purdue Pharma, which dealt with many tort claimants, or Johns-Manville Corp., which featured egregious breaches of environmental and health laws, are (thankfully!) comparatively rare. On the contrary, in *all* cases involving local public entities in distress, the beneficiaries of their services are usually directly or indirectly the main contributors to the entity's income.[28] This makes for a powerful argument for including their interests in any debate on the restructuring of the local public entity, even if they are technically qualified as contributors rather than creditors of the local public entity.

These considerations suggest that substantially fair deviations from the principles of collectivity and equality of treatment should not be justified primarily by the beneficiary's ability to contribute new value to the restructured entity, as happens in business rescue procedures. They suggest that deviations from those principles should also be designed to protect the vulnerable and non-adjusting beneficiaries of the services provided by local public entities. This draws limited parallelism of purposes (but not outcomes) between business liquidation procedures and procedures involving the treatment of local public entities in distress. The next section builds on the comparative analysis of the study to determine to what extent the interests of vulnerable and non-adjusting claimants are protected and promoted in procedures involving local public entities in distress.

3 | FINDING A FAIR PRINCIPLE OF CONTINUITY OF PUBLIC SERVICES?

3.1 | Classification of the states considered in the study and other preliminary findings

Overall, our study showed that countries around the world adopt very different approaches to the treatment of local public entities in distress. Our study was mainly concerned with

analysing the legal framework for treating local public entities in distress, rather than discussing the effectiveness of the mechanisms to turn around distressed entities.[29] Our analysis shows that it is possible to categorise these frameworks into four big families:

1. Comprehensive special insolvency systems. The countries in this group have a special insolvency framework applicable to local public entities that are in either distress or insolvent. In our study, we believe that the only country eligible for inclusion in this group is the United States.
2. Comprehensive administrative systems. The countries in this group do not allow their local public entities to have access to 'traditional' insolvency procedures. However, they allow their entities to have access to comprehensive administrative procedures designed to ensure the continuity of public services. Because of the highly developed nature of these frameworks, the intervention of the state in the form of a discretional bail out is—at least on paper—generally not necessary. In our sample, we believe that the following frameworks should be included in this group: Belgium, Brazil, Italy (where the conditions for state bail outs are clearly set out in the law), Japan, the Netherlands,[30] and South Africa.
3. Fragmented or special administrative systems. The countries in this group do not allow their local public entities to have access to 'traditional' insolvency procedures. However, they have enacted some special rules designed to deal with the entity's distress in an orderly manner. Because these frameworks are of special or fragmented nature, intervention from the state in the form of a bail out is likely whenever the local entity faces serious distress or insolvency. The conditions for state intervention are mainly discretionary. In our sample, we believe that the following frameworks should be included in this group: Australia, France, Germany, the People's Republic of China (with reference to state-owned enterprises), the Russian Federation, and the United Kingdom.
4. Light-touch approaches to distressed local public entities. The countries in this group do not have a special set of rules applicable to local public entities in distress and do not allow them to use the procedures available to insolvent companies. Frequently, the rescue of distressed entities is achieved through informal workouts with the creditors or thanks to financial support from higher-ranking entities or central authorities. In our sample, we believe that the following frameworks should be included in this group: Argentina, Bangladesh, Canada, Ghana, Nigeria, the People's Republic of China (with reference to public entities), and Uganda.

The categorisation does not reflect the effectiveness of each system in reaching the goals laid out in the law. For instance, there is no recorded case of bail out of local entities from central authorities in the People's Republic of China, probably by reason of the stringent control of central authorities over local finances. On the other end of the spectrum, the analysis of the South African framework shows that a range of practical issues affect statutory interventions in municipalities, even though the system is on paper capable of dealing with these issues without the need for discretionary state or central support.

Local authorities across the world share some common characteristics. Unlike private companies, their *revenues* are supplemented by local taxes and other types of levies. In many cases, local authorities receive significant financial support from central governments in the form of direct transfers or ring-fenced funds.[31] This should ensure a constant and relatively predictable stream of money to the local authorities.

However, local authorities are not always free to complement their funding with additional sources. In states such as the UK and South Africa (among others), they are limited in the amount of money they can charge for the services provided. In Canada, local public entities are only able to access debt through their municipality, which issues the debentures in the municipality's name. Sometimes, local public entities have very limited autonomy to determine their goals and policies, or to increase their revenue capacity through taxation. This is especially true in relatively centralised states such as England and France. Local entities enjoy wider autonomy and revenue collection powers in federal states. This is, for instance, what happens in Belgium and Germany.

In general, states place significant constraints on the financial activities that can be undertaken by local public entities. A notable example is Canada. This approach has the benefit of limiting the number of entities that have needed assistance or support over the years. If an entity is limited in how much it can borrow, it is less likely it will find itself in a condition of insolvency or financial distress. However, this is no guarantee that cases of local public entities in distress will not happen at all, as corporate scandals and major economic shocks have had and continue to have an impact on local public entities and their ability to service their debt. For instance, in Canada, despite the existence of strict borrowing rules, several local public entities defaulted on payments in the 1930s. Nowadays, local public entities in Canada (and around the world) face similar issues, as they operate in a market characterised by rising costs and dwindling revenues. Not dealing with the possibility that one of these entities may default on their payments is equivalent to 'looking for trouble'.

Additionally, some states, as in the case of Ghana and Nigeria, do not allow local entities to levy their taxes autonomously. These taxes are paid to central authorities and then redistributed to local entities based on pre-agreed criteria. However, these criteria are subject to constant political negotiations between local and central authorities, and central authorities may fail to pay promptly or as much as promised to local entities. Finally, there are states like the Russian Federation where some types of unitary legal entities do not own assets provided to them by public law entities. These entities (usually companies created by public law entities) acquire special rights of economic or operational management on certain assets, some of which are put out of the reach of creditors, thereby reducing the chances that creditors may be successful in enforcing claims against these entities.[32]

Our analysis shows that the revenue-generating capacity of local public entities differs greatly from state to state. Overall, it seems that systems, where local entities enjoy tax collection powers grant more autonomy and allow for longer-term planning over indirect transfers from central authorities, provided that strong corporate governance rules are put in place to ensure that local administrators are held accountable for the money they spend. A system of direct collection from local authorities increases the local administrator's accountability towards local communities and reduces the discretionary and political interference from central or higher-ranking authorities.

Except for Italy, South Africa and the USA, our study shows that few countries around the world feature a robust and well-developed *insolvency or administrative framework* for dealing with local public entities in distress. Even in countries, such as the USA, where this framework is well-developed, there are difficulties in assessing its scope, as the definition of 'municipality' (the equivalent of 'local public entity' in American English) is far from settled.

Italy is a very interesting case study. There is a special code, known as 'Testo Unico delle leggi sull'ordinamento degli enti locali' (TUEL), which deals with any issues surrounding local public entities in distress. This includes situations of financial imbalance and distress. The Italian TUEL

adopts a modular approach to the treatment of these entities, with different remedies available based on the severity of the entity's economic and financial situation. Even in the most serious cases requiring the appointment of special experts, the local management is not displaced (unless in case of criminal or grossly negligent behaviour), and the state intervention is subject to specific procedural and substantive checks, to ensure that it is not applied in an arbitrary way.

The less-known experience of South Africa has provided significant material for our study. South Africa also provides a modular approach to the treatment of local public entities in distress. This framework encourages local entities to deal with financial shortcomings by raising revenues and reducing expenses. If this proves ineffective, the provincial authority will intervene, first to support the local entity, and only eventually replace its management to devise a more comprehensive restructuring. Local public entities may also be placed in administration. Finally, in cases of a serious or persistent material breach of financial commitments, provincial or state authorities are obliged to intervene and—potentially—displace the management of the insolvent entity.

There is also the peculiar case of Uganda. Under Ugandan law, local public entities are not subject to 'traditional' corporate insolvency procedures. The Government has the discretionary power to intervene when these entities are struggling financially. However, in some of these cases, the Government decided to use 'traditional' procedures, such as administration, receivership or (as a last resort) liquidation, to offer an orderly and fair process to all stakeholders. It follows that, at least in this country there is no apparent valid justification for not extending the scope of the existing insolvency framework to local public entities.

Therefore, our study evidenced a very fragmented approach to the treatment of local public entities in distress. Despite some minor commonalities (evidenced below Section 3.3), the treatment of local public entities in distress is mainly a domestic matter subject to a significant degree of political interference. As it stands, few of the considered frameworks achieve any form of procedural fairness, let alone a substantive degree of protection for vulnerable stakeholders.

The urgency to intervene in a principled way in the area is compounded by the fact that many countries are relying to an increased extent on *public-private partnerships* to deliver essential services to local communities.[33] This factor makes the distinction between local public entities and private providers even more challenging to discern. It also raises additional problems as to their qualifications, and the regime applicable to them should they experience a condition of insolvency or financial distress.

One of these cases is China, as the country does not have specific provisions dealing with local public entities in distress. However, many of its state-owned enterprises provide public services and are subject to general insolvency rules. The same occurs in most of the African countries considered in this study (Nigeria, Ghana and Uganda). In these countries, there is some evidence that informal debt resolution mechanisms have proven successful over time.

We believe that a praiseworthy example of how to deal with public-private partnerships comes from South Africa. Under this law, public-private partnerships are subject to the control of a 'parent municipality'. Should the partnership fail to meet the financial requirements prescribed by the law, the parent municipality will be able to impose a restructuring plan on the partnership, using the same powers granted to provincial authorities dealing with 'basic' local public entities in distress. Alternatively, the parent municipality will be able to liquidate the partnership, relying on powers not recognised by provincial authorities under South African law. Other countries, such as Italy and the Netherlands, provide for special rules and procedures applicable only to basic local public entities, while hybrid entities are subject to the general insolvency provisions. The effectiveness of this approach is analysed below.

The next sections expand the comparative analysis to other areas considered in this study and assess them against the normative framework provided in Section 2. We distinguish critical and uncoordinated approaches to the treatment of local public entities in distress (Section 3.2) from what we describe as best practices. These best practices ensure the continuity of public services and the protection of vulnerable stakeholders (substantive fairness) without deviating too much from the procedural funding principles of insolvency law (Section 3.3). The final sub section of this part draws our conclusions on the findings of this study.

3.2 | Uncoordinated approaches or critical aspects in the treatment of local public entities in distress

Our study shows that some aspects of the current treatment of local public entities in distress result in uncoordinated approaches among different actors, as well as in the promotion of practices that are incompatible with the existence of a procedurally collective, equal, and fairness-oriented insolvency framework.

3.2.1 | Uncoordinated approaches

Many reports show a *lack of coordination* in domestic strategies for dealing with local public entities in distress. This is particularly evident in federal countries such as Australia, where regulation is undertaken by respective State governments. A similar trend is also apparent in the United Kingdom, where there are significant discrepancies in the treatment of local public entities among the states in the Union, as well as in Canada, where restrictions on 'municipalities' and their financial activities differ from state to state. Yet another example is Argentina, where each municipality is governed by ad hoc provincial law, and the treatment of distressed municipalities varies from province to province.

Another federal state where there is an evident lack of co-ordination among the different branches of the state is Nigeria. In this African country, local public entities are not subject to special insolvency procedures, and the Constitution does not provide for their dissolution. However, several federal states have enacted special laws, which allow for ad hoc dissolution procedures for special local public entities. The lack of a co-ordinated approach between central and federal entities often results in the central Government having to bail out the debts of local entities on a case-by-case basis.

Bail outs are far from being an optimal solution, as evidenced by the Ugandan case. In that country, in 2016 the Government spent the equivalent of US$ 300 million to bail out distressed companies (including state-owned companies and local entities), as they were considered viable and still capable of contributing to the economy. Such an initiative was later criticised for being politically motivated. It is undeniable that bail outs have a political, rather than simply financial, cost.

3.2.2 | Insufficient incentives for early filing

Many reports observe that there are *few incentives* to deal with local public entities in distress at an early stage. This includes reports from countries such as Italy that have a working and comprehensive framework for dealing with local entities in distress.

This situation is not limited to Italy. The English report, for instance, notes that there are perverse incentives not to disclose ongoing financial difficulties, as this would lead to the existing management being supervised and eventually replaced by independent commissioners appointed by the Government. This is because the only way of dealing with local public entities in distress under English law is by means of s.114 Notices. When these notices are issued, the local authority must convene a council meeting to discuss the actions that need to be taken to address the financial challenges. These consequences usually result in the approval of a rescue package with the support of the Government, as well as in the ousting of the existing management.

The harshness of the consequences associated with s.114 Notices have been designed to push councils to take timely decisions and, therefore, avoid experiencing serious financial pressures. Yet, the punitive and draconian consequences associated with s.114 Notices also have the unwanted and collateral effect of incentivising the existing management to hide the magnitude of the local authority's financial problem until it is too late to devise solutions at a local level, for the sole selfish purpose of avoiding being replaced.

Similar punitive and management-displacing approaches have been observed in many other countries. For instance, in Australia there is legislative power for persons, such as governors, to dismiss all civic offices in relation to a council where a public enquiry on their financial soundness has been held, and where the Minister has recommended that the Governor make such a declaration. In Croatia, as local public entities are not subject to general insolvency law, they can be admitted to a special rehabilitation procedure carried out by higher-ranking public entities with the purpose of ensuring the continuity of public service. This rehabilitation procedure results in the management being displaced for a period of up to 2 years.

The lack of incentives to file is compounded by the fact that in many cases state or federal oversight may result in the dissolution of the local public entity. Cases of this type were recorded in England, while in Australia there is legislative power to merge local authorities.

There are some exceptions to this trend of offering no incentives to deal with distress at an early stage. In Belgium, distressed entities that jointly propose a merger can, in principle, enjoy a reduction in their debts through a partial bail out from regional governments. The portion of such debt is pre-determined by the law, and it is linked to the number of inhabitants of the merged authorities. We argue that this is a very good example of tackling local financial distress in a principled way. In general, under Belgian law, debts must be paid as originally agreed. However, deviations are possible under pre-identified conditions and standards, and only for the purpose of ensuring the provision of essential public services to local communities. In other words, collectivity and equality of treatment of creditors are displaced only when no other option is available, for the purpose of promoting substantive fairness, and on the basis of pre-arranged and identified criteria.

Not all countries require the removal of local officials upon the opening of a procedure involving local public entities in distress. Under US law, Chapter 9 of the Bankruptcy Code allows those in charge of the distressed entity to retain their position during the proceedings. State laws may also provide for mechanisms of additional oversight of the existing officials to ensure that inefficiencies and existing problems are addressed in a timely manner. Other states such as Belgium provide for 'special oversight' and limited powers for higher-ranking entities to take decisions on behalf of local authorities. Only in exceptional circumstances, such as manifest unwillingness or negligence on the part of a local administration to comply with its legal obligations, can the higher authority displace the management of the local entity by means of 'coercive supervision'. This approach is similarly followed by South Africa, where management

displacement is seen as the *extrema ratio*. Finally, in Italy, 'extraordinary liquidation bodies' are called in by the entity to try to settle its debts with the creditors, while the management of the entity remains in place to perform ordinary obligations and functions, as well as to remove the causes of the financial distress.

3.2.3 | Ineffective corporate governance rules

Management-displacing aspects and lack of co-ordinated approaches to local public entities in distress are not the only elements that corroborate the trend for late filings. Another aspect is the lack of effective *accountancy* rules and comprehensive provisions for the investigation of the *conduct of the entity's officials*.

Where strict accounting and reporting rules are implemented (such as in Belgium, Canada, France, Germany, Japan, the Netherlands, and the Russian Federation), local public entities are less likely to experience financial distress or insolvency. Particularly praiseworthy is the Japanese system, which features an alert system based on different financial and accounting ratios used to determine the financial soundness of the local public entity. Where the distress is unavoidable—for instance, because the failure is due to external factors such as mass migration, closure of main industries (for instance, mining industry) or natural and man-made disasters (for instance, radioactive contamination)—the higher-ranking authorities can intervene and provide support at an early stage.

With reference to managerial accountability, while previous management is generally subject to the general criminal and company law provisions on directors' conduct, it seems that states do not enforce these provisions with a robust prosecution system. Some notable exceptions apply. This is, for instance, the case of the Netherlands, where provincial executives (civil servants acting as a board on behalf of the Provincial governments) have the power to initiate, at any time, a financial investigation regarding the entity's financial policy, albeit only with reference to basic local public entities. Notably, such an investigation does not automatically result in the displacement of the existing management. We believe that not displacing the existing management at the first sign of crisis, or when investigations are initiated, is one of the aspects that countries should closely consider in any reforms of their frameworks on local public entities in distress. The fact that this investigation is carried out by civil servants is, however, a reason for concern in principle if no appropriate guarantee is embedded in the system.[34] A process of administrative and internal overview does not ensure the same level of transparency (and, therefore, public accountability procedural fairness) as a process carried out by an independent, third-party authority.

A country that has a well-developed corporate governance system is South Africa, at least on paper. Under this law, local public entities are subject to detailed rules on financial management, including reporting and borrowing rules. The South African Constitution mandates that municipal budgets and budgetary processes must promote transparency, accountability and effective financial management of the economy, debt, and the public sector. There are reporting obligations if the entity fails to perform to the statutory standards and, if the allegations are proven, the entity can be put in administration and its directors may be forced to pay damages to the entity itself. Additionally, a failure to adhere to the substantive statutory requirements, especially the limits on lending, may lead to the invalidity of the transaction with the creditor. According to the South African commentator, however, this is a case where the three underpinnings of the multi-faceted notion of procedural fairness do not result in a substantially fair framework.

The reason for such failure is to be ascribed to the discretionary, somewhat arbitrary *state intervention* in these procedures. In South Africa and in many other countries (such as in the UK and Canada), state intervention frequently results in the provision of broad and unlimited guarantees to the entity's debts. One such egregious case is Uganda, where the state stands in loco parentis and is responsible for any legal remedies, such as damages, arising from the contracts signed by the local authority. State intervention also results in putting some assets beyond the reach of the debtor's creditors, as in France, Belgium and the Russian Federation, among others. These measures incentivise moral hazard or careless assumption of excessive debts by local directors, as evidenced by several reports. This is debt for which, ultimately, the local entities are not accountable. The existence of these guarantees does not encourage the entity's creditors to check the financial solidity of the entity before investing in, it or to hold the entity's directors accountable for their actions. As a result, serious issues are only disclosed when the only option left is bail out by the state.

Despite being marred by unwanted political interference, the South African framework suggests a potentially promising approach for dealing with these situations. Under South African law, entities may not dispose of a capital asset needed to provide the minimum level of basic municipal services, regardless of their financial distress. Such assets—but only such assets—are excluded from the entire framework dealing with financial distress. This may represent an acceptable compromise position, provided that these assets are identified in advance so that third parties can clearly assess their risk in investing in that entity.

Japan has adopted a form of state intervention that is not political in nature. Its law provides for national financial assistance in the form of state-guaranteed bonds if a local entity finds itself in financial difficulties. The law outlines clear criteria and ratios to have access to this type of support, meaning that political discretion is minimal. In other words, this is a form of state intervention devoid of political discretion and capable of ensuring procedural fairness. However, this approach is not in itself sufficient to ensure substantive fairness. Similar yet less technically rigorous approaches are also implemented in other countries included in this study. For instance, in Germany, the law (including the country's Constitution) clearly outlines the local public entities' sources of income and the subsidiary support from the federal state. There are also clear prohibitions on becoming over-indebted, thus ensuring once again high levels of accountability and procedural fairness.

3.3 | Commonalities in the treatment of local public entities in distress

Despite the fragmented framework described so far, our study also evidences common elements and shared approaches to the treatment of local public entities in distress. Their implementation by the states results in minimal deviations from the traditional, procedural tenets of insolvency law. At times, it also shows a willingness to promote substantively fair goals. This suggests that a principled approach to the treatment of local public entities in distress is within reach.

3.3.1 | Unitary purpose-based definition of a local public entity

As mentioned above, local authorities are charged with providing *essential services* to local communities. These services are provided either directly by these entities or through private or semi-public companies. In the USA, the law describes local public entities as, inter alia, an

'instrumentality' of the state. US case law clarifies that to assess whether an entity is an instrumentality of the state, reference needs to be made to the purpose of that entity as well as to the level of control from other higher-ranking authorities. It follows, therefore, that there is some agreement that to determine the public nature of these entities it is necessary to look not simply at the controlling structure, but also at the purpose and nature of the services provided.

Many more countries, however, do not provide a single definition of local public entities. At times, local, regional and central definitions are contradictory. As evidenced by several reports, this causes uncertainty and confusion in the application of the law. Other reports such as the Ghanaian one highlight that the law does not distinguish between local public entities and local governments, thus bringing into question the ability of the system to cater to the specific needs of local entities, especially when it comes to the needs of vulnerable stakeholders. Where well-drafted unitary definitions are provided, clarity may be enhanced, thus improving the framework's ability to deal with a situation of financial or economic distress of these entities.

In some instances, the local nature of these entities is questionable. For instance, in Ghana, essential services are provided by state-owned companies that operate at a national level. These entities have local branches, but the structure of the corporation is unitary. These corporations can become insolvent but in practice, they are never formally dissolved.

3.3.2 | Promotion of collective outcomes

Despite the lack of co-ordinated approaches in many of the areas discussed above, the laws analysed in the study generally ensure a procedurally *collective* approach to the treatment of these distressed entities. This result is often achieved by means of administrative supervision, even if some jurisdictions such as the USA opt for judicial oversight and others like Italy for a mixed system where administrative judges support the work of externally appointed experts and existing managers. In a similar fashion, in France, the collective nature of the procedure is ensured even if the entity is dissolved or merged with another authority, as the process is governed by laws or orders (ordinances).

In corporate insolvency cases, restructuring plans are often agreed upon out of court. The collective nature of insolvency procedures does not represent an obstacle to negotiating extra-judicial solutions to the debtor's distress. It is, therefore, notable to observe that in some jurisdictions such as the USA and Croatia, *mediators* and similar professionals are employed to assist the parties in negotiations designed to achieve an amicable solution to any disputes arising during the insolvency procedure. Their intervention is not designed to challenge the procedurally collective nature of these procedures, but only to facilitate a compromise between the affected parties.

3.3.3 | Ensure the continuity of public service

As it appears, many of the procedures covered in this study are management-displacing and lack incentives to deal with financial distress at an early stage or in a coordinated manner. Despite this, local public entities are not left without support. The protection of public services features a prominent role in almost all the frameworks considered in this study. Many frameworks are designed to ensure the provision of essential services and their *continuity*, irrespective of their level of sophistication.

For instance, the English report observes that, while the concept of 'continuity of public service' is not embedded in the legislation, much of the current law is clearly geared towards

achieving this goal. This also applies to companies strictly connected to local authorities but formally independent from them. Under English law, the issuance of a section 114 Notice results in a prohibition of incurring new expenses. However, this prohibition does not cover statutory services, including safeguarding vulnerable people, and existing commitments and contracts will continue to be honoured.

The Australian report reaches similar conclusions on this point, as it observes that the concept of 'community' is central to the laws dealing with local public entities in distress. The report goes on to observe that, although the avoidance of insolvency is not mentioned specifically, continuity of public service is a clear part of providing a sustainable, flexible and effective system of local government that delivers to local communities. Similar provisions also apply to Bangladesh, which de facto extends the scope of the principle of continuity of public services to private companies (owned by the state) delivering essential services to local communities.

Some states grant special protection to the principle of continuity of public services. In Belgium, this is a general principle of administrative law, which takes priority over competing demands from the creditors to seize the entity's assets and sell them in satisfaction of their claims. The same goes for France, with the result that if public utility establishments are dissolved, the essential services they provided fall back to another local authority. A similar approach is also followed in Italy, where guaranteeing the functions and services provided by local public entities is one of the specific goals of the procedures applicable to these entities (and recognised by the case law). Moreover, it is expressly stated that an important aim of the South African legislative framework is to secure the continuation of public services despite their financial distress. Finally, some states such as Germany include not only the principle of continuity of public services but also the more general principle of continuity of municipal entities in their Constitution.

Other states such as the Netherlands do not clearly state in their laws the need to comply with a principle of continuity of public services for hybrid entities. However, they do allow their hybrid local public entities to take part in procedures such as 'suspension of payment'. These procedures have the effect of giving the distressed entity a period of relief from executory actions against their assets, so as to regain their financial viability. With reference to basic local public entities, the continuity of public services is ensured by the special administrative provisions applicable to them. Such provisions are geared to address the basic entity's financial distress, thus indirectly ensuring the continuation of public services.

Similarly, in Argentina, some of the provinces set limits on what may be accomplished via judicial foreclosure of municipal assets so as to maintain the provision of essential public services. And in Brazil, local public entities cannot be insolvent or liquidated, and public debt renegotiations must be formalized through a complementary law. Finally, there are states such as China where, even though insolvency procedures are not available to local public entities in distress, the law allows those entities to terminate, amend or assign the contract when this is considered in line with 'social interests'. It is submitted that, in a situation of financial distress, the notion of 'social interest' is equivalent to ensuring the continuation of public services.

Therefore, we believe that all states considered in the study have geared their frameworks and actions to ensure that instances of substantive fairness (particularly the protection of vulnerable stakeholders) prevail over competing calls to ensure the procedural tenets of corporate insolvency law.

Nearly all the states considered in this study ensure the continuity of essential public services by *preventing local public entities from being liquidated*, as clearly stated under the US, French and Belgian laws (among others). However, these two aspects are not consequential. Essential services could be provided by neighbouring local authorities, which could hire some

of the workers and purchase some of the equipment of the distressed local public entity. In other words, the resolution of the entity's financial distress could well take the form of a merger, pre-packaged sale or scheme of arrangement with another entity. There is no valid reason to prevent in principle the dissolution of a local public entity in distress. In France, for instance, the law created a principle of last-resort state liability for the debts of legal entities governed by public law. In practice, the mergers mentioned above are processes for liquidating local public entities.

The Belgian report argues that dissolution could not be possible for the disruptive effects that such an outcome would have on federal, state, or other local authorities. This argument is legally flawed. It is the purpose of the law to provide mechanisms for the regulated administration of an entity in distress. Prohibiting liquidation is not the same as prohibiting insolvency unless local entities are also prevented from taking on any form of debt.

While preventing the dissolution of local entities might not be justified, there might be a case for ensuring that local entities are protected against *executory actions* promoted by their creditors, at least for the duration of the turnaround or restructuring efforts. However, provisions ensuring the suspension of individual proceedings against local entities are not common under the laws considered in the study. The notable exceptions are, once again, the US and Italian law, which provide for an automatic stay against all collection actions against the debtor. South African law provides for similar relief only in liquidation procedures.

Despite the absence of general provisions or an automatic stay, the case studies discussed in this project do not evidence a generalised trend towards the depletion of the local public entity's assets before or during the collective procedures affecting local public entities in distress. This may be since some of the assets used by these entities belong to the state, and cannot be seized or sold by the entity's creditors (as is the case, for instance, in Belgium, France, Japan and the Russian Federation).

3.4 | Concluding remarks on the comparative analysis

Legislators are usually reluctant to disrupt contracts negotiated between parties at arm's length. "Freedom of contract is the order of the day and the orthodox philosophy is that parties should live with the bargains they have struck".[35] Yet, the principle of continuity of public services encourages deviations from this narrative, when it is objectively fair to do it.

The importance of promoting the substantially fair and procedurally collective and rateable treatment of creditors is indirectly recognised by some national laws. These laws identify the principles of 'continuity of public service' and transparency as general principles of the public policy governing the treatment of these entities.[36] It does not provide legal certainty to have cases, like the ones described in the Croatian report, where it is not clear how local entities previously in serious financial distress have been given additional funds and rescued. These findings represent the foundations upon which we have provided a series of harmonised recommendations on the treatment of local public entities in distress.

4 | RECOMMENDATIONS

Despite notable exceptions (as in the case of Belgium), several commentators around the world have raised concerns that local public entities face various challenges in maintaining fiscal sustainability. These entities face escalating demands on resources due to inflationary trends and

growing demand from an ageing and poorer population, while simultaneously experiencing dwindling revenue-creating capacity. The absence of vision and purpose in dealing with distressed local entities causes uncertainty among creditors and in the financial markets.

Several commentators also observed that the lack of an appropriate framework for dealing with local public entities in distress does not result in preventing these entities from going insolvent. It only results in unprincipled, last resort and ad hoc procedures featuring the intervention of a higher authority to cover existing debts with taxpayer money. The lack of a principled statutory framework for their treatment means that whether this assistance will actually be forthcoming, what form it will take, and any conditions that may be attached to it, are questions of politics rather than of legislative interpretation.

This system is neither efficient nor effective in ensuring the continuity of essential public services to local communities in a substantially and procedurally fair manner. It does not result in creditors being treated collectively and fairly. As a result, we believe that the states should reform their systems and opt for either of these two approaches, ranked in order of preference:

1. A special insolvency framework with options for liquidating, restructuring or merging local entities. Its rules should replicate as much as possible the domestic procedures available to companies in distress and uphold the procedural tenets of corporate insolvency law. Deviations from these insolvency rules should only occur in order to protect vulnerable parties and reward the beneficiaries' contribution to the local entity (substantive fairness);
2. A special administrative framework with options for liquidating, restructuring or merging local entities. Its rules should uphold the procedural tenets of corporate insolvency law. These administrative rules should be designed to protect vulnerable parties and reward the beneficiaries' contribution to the local entity (substantive fairness).

To achieve substantive fairness while not significantly departing from the procedural tenets of corporate insolvency law, we believe that the following recommendations should be implemented.

4.1 | General recommendations for dealing with local public entities in distress

4.1.1 | Introduce a unitary definition of 'local public entity'

As mentioned in the introduction, definition matters. As observed by the Canadian commentator, the absence of a single coherent definition of 'local public entity' or its equivalent precludes statutorily codified mission statements and defining elements. When this unitary framework is provided—such as in Italy, France or in Japan, where the notion of 'local public entity' is found in the Constitution—it is important that the activity of local public entities is restricted in scope. When 'local public entities' are allowed to provide products and services otherwise largely available in a competitive market beyond local users, the justification for any form of special procedure or treatment of these entities in distress disappears.

Despite the Italian commentator describing the possibility of agreeing on a unitary definition of 'public entity' at the domestic level as 'utopian', we believe that states should agree on an encompassing definition of *local* public entities[37] based on the functions they perform, the ownership of the entity itself and their territorially limited scope. In other words, national

legislators should rely on institutional and functional approaches to the conceptualisation of public entities in law (see, for instance, the South African and Italian approaches).

The institutional definition should be qualified by the functional approach, as not all public entities are local or provide essential services. Local public entities should be seen as organs or agents[38] of the state, invested with public and regulatory (unless these powers are not needed for the performance of their functions) but not statutory authority.

Clear criteria should also be introduced to determine the notion and treatment of private-public partnerships when they are the sole providers of essential services in a given local community. There is a case for treating these entities in the same way as 'traditional' local public entities considering the similar functions they perform, even if some states (such as Uganda) apply 'traditional' company and insolvency rules to these partnerships and companies and 'special' rules to local entities.

This study suggested distinguishing between 'basic' and 'hybrid' local public entities. 'Basic' local public entities have been described as public authorities or entities partially or totally funded by tax levies that provide essential services (such as transport, education, social housing and care, hospitals, and utility services), not necessarily or always at market price, to local communities. 'Hybrid' entities have been described as publicly or privately owned entities (including corporations) with varied sources of revenue that carry out fundamental services or are responsible for the production or distribution of essential goods at local (territorial or regional) levels. These services must represent the prevailing business of these hybrid entities, are usually provided at competitive prices, and another local authority or municipality must ultimately be responsible, legally or politically, for all of part of their debts. We suggest that these definitions could be used as model definitions by domestic legislators.

We acknowledge, however, that these definitions may not work for socialist economies (such as China), where (some) companies are owned by the people, and where there is no conceptual difference in the powers exercised by state-owned enterprises and local public entities.

4.1.2 | Limit political interference

In non-unitary insolvency frameworks, states and regional authorities should be allowed to provide mechanisms to assist financially distressed local public entities under pre-identified criteria (as in the case of Japan), to ensure public accountability procedural fairness. Significant interference from state and regional authorities may detrimentally affect the ability of the parties involved in these procedures to shape a satisfactory and agreed outcome of the case. It is welcome, therefore, that in states such as Bangladesh, the judiciary clarified that the central government cannot interfere in the functions ordinarily carried out by local public entities. Unfortunately, in Bangladesh, these entities cannot be liquidated or rescued unless with the prior permission of the Government.

In general, deviations from agreed and statutorily codified practices should be kept to a minimum, to ensure that the continuity of essential public services is not achieved at the expense of the other procedural tenets of insolvency law. Special treatments can be envisaged for those entities that are essential for the country's security, or for public policy reasons. However, it is envisaged that only a few *local* entities may meet the stringent 'national security' or 'public policy' criteria mentioned above (for instance, in cases of large municipal transport systems).[39]

What must be avoided at all costs is the perception that the legislative framework is unevenly applied, and that interventions from higher-ranking authorities are in practice entirely within those executives' discretion. This widespread perception—supported by empirical evidence from academic studies—may well explain why the South African advanced framework for the treatment of local public entities in distress performs poorly in practice.

4.2 | Recommendations as to the guiding principles for dealing with local public entities in distress

4.2.1 | Strengthen the corporate governance framework

As evidenced by several commentators, particularly from Nigeria and Ghana, the absence of fiscal autonomy is a major drawback to the development of a comprehensive framework for the treatment of local public entities in distress.

National states should strengthen the rules applicable to accounting standards and report to local public entities. National states should enforce strict budget rules and put in place a system of independent checks and balances that allows independent parties to intervene in a timely manner when local public entities are deviating from balanced budgetary rules. As mentioned in the Chinese report, the establishment of effective credit systems and stricter lending rules can operate as a pre-insolvency system by preventing entities, including local governments, from becoming over-leveraged.

As rightly happens in Ghana, these strict accounting and reporting rules should also apply to local state-owned corporations charged with providing essential services. More in general, if local entities operate by means of companies or partnerships subject to traditional company laws, deviations from traditional accounting standards should be considered if the local entities are directly or indirectly responsible for their debt, or if these companies and partnerships provide essential services to the local community.

There is evidence that stricter accounting rules result in financially wealthier local public entities. Where these strict rules are implemented and local entities are granted either sufficient autonomy in setting their revenue (such as in Belgium and France) or predictable transfers from higher-ranking authorities, the financial situation of local entities is generally good.

Cases like subsequent rescue deals negotiated by the mayor of London with the UK Department of Transport to keep the local transport company afloat (Transport for London) are to be avoided as much as possible. Where there is no pre-agreed and binding transfer plan, higher authorities have a perverse incentive to not negotiate long-term funding deals to exercise political control on local authorities. While this may at times be justified to keep labour costs under control, this practice has the unwanted effect of preventing the local authority from making long-term investment plans and improving the service provided to local communities. Lack of funds invariably results in a lack of investment in environmentally friendly policies, safety hazards, customers dissatisfaction and the need to agree on further emergency support at a later stage.

The accounting and reporting measures should be complemented by an expansion of the investigatory powers exercised by the prosecution and independent authorities, to ensure that local managers are held accountable for gross misconduct, negligence, fraud, or corruption.[40] These powers should be exercised by independent authorities, or at the minimum by civil servants from a higher-ranking public entity acting only to ensure compliance with the law, and

not on merits, in order to avoid any claim of collusion or political use of statutory powers (thus, once again, affecting the public accountability facet of procedural fairness). Like the Croatian approach, egregious cases of breaches of accounting rules should result in civil and criminal liability for the perpetrators. Croatian law also dictates that, if the failure of the local entity is due to political interference by another local public entity, the latter can be held accountable for any damage caused to the distressed entity.

There are states that have introduced effective measures to hold a local public entity's managers accountable. One of these is South Africa. In this country, the managers of these entities can reach rescue agreements with the entity's creditors. Once a rescue has been agreed upon, the entity must report monthly to the provincial government on such implementation. If it fails to do so, the provincial government may dissolve the municipal council and appoint an administrator to oversee the management of the municipality until a new council is elected. While we are not sure of the need for monthly reports, it is certainly praiseworthy that monitoring mechanisms introduced by the law exercise significant oversight on managers, which are dealing with entities in difficult financial conditions.

An issue associated with effective corporate governance is the adoption of effective measures against corruption and collusion. These problems have been raised in several reports, particularly from African countries (see the Nigerian report). At the EU level, the Conditionality Regulation especially includes local entities within its scope of application and provides for mechanisms to address instances of corruption and collusion in the EU Member states and thus ensure the effective implementation of anti-corruption and anti-collusion frameworks.[41] Finally, it was welcome to observe that some countries hold municipalities accountable when a board forces hybrid local public entities to take unprofitable decisions that, eventually, lead to their insolvency. In the Russian Federation, for instance, the Supreme Court confirmed that municipalities can be held liable for the activities of hybrid entities created by them if these entities forced the controlled companies to supply services at under-cost and denied financial support when needed.

4.2.2 | Allow for the statutory liquidation and rescue of local public entities

As a general principle, local public entities should be allowed to be liquidated or dissolved, without affecting the provision of essential services to local communities.[42] This is what happens in some of the countries analysed in this study, including France and the Netherlands.[43] Other countries, such as China, are considering the introduction of such a system in their insolvency laws.

This special framework should be largely based on the rules applicable in the corporate field, even if some deviations from mainstream corporate rules may be needed to ensure substantive fairness and the protection of vulnerable parties. We find it preferable not to introduce either special administrative frameworks even if this approach has proven successful in some countries such as Italy, or special procedures applicable only to local public entities. Despite this, some states, such as the Russian Federation with interim financial administration and the United Kingdom with s.114 Notices, have introduced special procedures applicable only to local public entities in distress. These administrative rules are still preferable to a framework where the state is called to bail out entities unable to serve their debts.

It is also important that the power to liquidate and rescue local public entities is exercised when needed and is not subject to political interference. In Ghana, for instance, state-owned

enterprises that provide public services are subject to 'traditional' insolvency procedures. However, in recent times there has only been one recorded case of a state-owned enterprise pushed into formal liquidation (Ghana Airways). In that case, the Government was forced to push the company into liquidation because its international creditors started seizing its planes abroad.

The need to ensure the continuity of public service may justify deviations from the principles of procedural collectivity and equality of treatment among creditors. One such deviation may, for instance, apply to the role of general creditors in these procedures, as in the case of South Africa, thus affecting the dignitarian facet of procedural fairness. This is because, in ensuring that essential services are provided, local authorities may make decisions that are against the best interests of the creditors. Therefore, it is unlikely that the creditors would ever approve such decisions.

However, these deviations from the general statutory rules applicable to 'traditional' insolvency procedures need to be outlined by the law, rather than applied on an ad hoc basis. In other words, states may resort to the traditional rescue procedures under their laws to promote a settlement among the entity's creditors or the adoption of a rescue plan. Mergers with other local entities should be encouraged as a mechanism to reach a settlement with the creditors and ensure the long-term viability of the distressed entity, even if this may lead to further legal complexities.[44] In other words, deviations from dignitarian fairness should be instrumental to achieving institutional and substantive fairness.

Besides the need to ensure the protection of public services, there is no compelling reason to deviate significantly from the established procedures applicable to corporate entities. In countries like France, public utility establishments that provide essential public services are still subject to general corporate insolvency and restructuring procedures. Their liquidation or merger with other authorities is regulated by the law and does not result in an interruption of public services. This could represent an effective approach for dealing with local public entities in distress. In countries like South Africa, there is a specific framework for local public entities (although these entities cannot be liquidated). Additionally, local entities that operate through companies can be rescued using the mechanisms available to private companies, with only minor amendments needed to ensure the continuity of public services.

The South African experience is particularly apt for the purposes of this study for the modular approach to local public entities in distress. Local entities are given wide latitude to deal with financial issues unless their solutions appear ineffective. They are then placed under the supervision of local authorities and only in the end, as an extreme solution, are they placed under the control of the central Government. A similar approach is also followed under Italian law, as evidenced Section 3.1.

4.2.3 | Deal with financial distress in a proactive way

States should introduce in their laws mechanisms to encourage the early detection of signs of distress affecting local public entities. This could be done by pre-determining the amount of financial support that could be granted by higher authorities should the entities in distress decide to merge into a larger authority (as it happens in Belgium).

Mechanisms to financially support the entity should be pre-determined (to avoid political bargaining) and not dependent on the time of filing, as this money is designed to protect vulnerable users. Mergers should be incentivised because they generally result in lower fixed and administrative costs for the provision of essential services.[45] However, they are frequently not considered by the existing management, because they would result in the loss of their jobs.

Together with incentives, states could foresee a system of disincentives for late filing, in the form of harsher fines for directors and auditors,[46] and mechanisms for their automatic displacement if they unreasonably delay the request for assistance.

It is important that the effectiveness of these measures is not hampered by conflicting provisions, for instance by the introduction of generally applicable management displacement mechanisms (discussed in Section 4.3.1). Especially when the entity's distress has not yet resulted in a situation of insolvency or when it has not been caused by the management's fraudulent or negligent behaviour, the existing management should be supported in taking the measures needed to restructure the entity's business (as it is usually the case in Belgium, Italy, and the USA). Equally, the local public entity's management should not be required to obtain preemptive state authorisation to file for collective insolvency or restructuring procedures, as this would disincentivise their use.

One way of promoting early filing is by means of a comprehensive package of relief measures for the distressed entity. These measures may well take the form of suspensions from executory actions, as evidenced above Section 3.3.3. Relief does not mean restricting the assets available for distribution for the benefit of the creditors. As correctly observed by the Russian Constitutional Court, this outcome is unsatisfactory to the extent that it creates the risk for abuse by local entities and allows public owners to shield themselves from most business-related liability.

An alternative approach could be limited under the law to the subsidiary liability of the state towards local public entities in distress. This is what happens in the Russian Federation, where the law provides that the higher-ranking entities shall bear subsidiary liability only for personal injury caused by the budget institution.[47] The critical point, however, is not to deviate from this predicament for political reasons. Other measures, such as compulsory mediation and conciliation procedures, could also be introduced under the law to deal with the entity's distress in a proactive manner. Another complementary approach consists in providing uniform provisions for interim financing, to ensure that private investors can support the restructuring efforts of the local entities. This is, for instance, the approach followed by the Dutch legislator, which allows for new or interim finance to be acquired and protected during any of the insolvency and restructuring procedures available to hybrid local entities in distress.

The importance of these measures appears clearly in the Nigerian report. As creditors are not prevented from suing local public entities for executory actions, and in the absence of an insolvency framework dealing with local public entities in distress, the Government is always forced to bail out local states and entities. Because the Nigerian system does not hold directors to account, the local entities have a perverse incentive to exceed their budgets, knowing that the Government will eventually 'pay the bill'. The same findings emerge from the Ghanaian report, although this report seems to suggest that effective negotiations between creditors and local authorities may result in a less frequent need for the national Government to step in and support the local entity.

4.3 | Recommendations as to the procedure for dealing with local public entities in distress

4.3.1 | Support and train without necessarily displacing the existing management

There is no reason to make rescue mechanisms conditional on the removal of the existing management, unless there is evidence that such management is responsible for gross mismanagement,

negligence, fraud or corruption, or they have otherwise proven unable to comply with legal obligations. Managing a local public entity is a complex and specialist task, and external managers from the private sector may not be familiar with the way a public entity operates. Special commissioners (as in Germany), private managers or qualified practitioners (as, for instance, in the Ugandan experience) may nevertheless be useful to support, supervise and suggest innovative ways to deal with the entity's distress. If these professionals are allowed to provide assistance to local public entities in distress, the law should clarify their duties and responsibilities to ensure that these professionals will not replace democratically elected officials in carrying out their core functions and duties.

An example of such an approach is the US practice, evident in some states, of appointing emergency managers or oversight boards to assist distressed debtors. Another good example is the Belgian approach, which provides a more stringent form of 'special' oversight and a 'coercive supervision' (with a management-displacing component) only where the general or special oversight had proven ineffective. Japan follows a similar approach, with a system of 'yellow' and 'red' cards based on the magnitude of the local entity's debt and distress. Neither in the case of a yellow nor in the case of a red card is the local public entity's management displaced in favour of external managers or administrators.

These success stories should be replicated where possible, provided that the costs of providing professional assistance are kept at reasonable levels. If management is displaced, there is the need to ensure that such a decision is taken by independent parties. Such a decision could, for instance, be taken by a pool of public managers, trained to deal with situations of financial distress. 'Training' is a keyword, as many reports evidenced the need for more experienced managers to deal with public finance. Trained local public entity managers and distressed specialists are likely to ensure a higher level of accountability and compliance with national and local roles, as well as to reduce the need for external financial support from other authorities.

Administrative oversight (implemented in countries such as Italy and the Netherlands) may prove more cost-effective, but less efficient in terms of outcomes, as public authorities may refrain from taking the tough decisions that are needed to deal with the entity in distress. Unlike the Netherlands, the large number of recurring filings in Italy seems to suggest that independent oversight is preferable to administrative oversight. Equally, states should explore the use of ADR mechanisms to facilitate negotiations with the entity's creditors.

However, one commentator from a country (South Africa) where the existing management is not displaced in such procedures doubted the wisdom of retaining failed leadership in the municipalities. In some of the examples provided in that report, it was apparent that more effective and successful rescues had been implemented when the existing management was displaced in favour of externally appointed administrators. The report shows that, in reality, there had been several cases of ineffective cooperation between the existing management and the supervisory administrator. Therefore, we argue that the solution lies in introducing incentives to make this cooperation more effective. Some of these incentives may also include a harsher treatment of the existing management in case the entity's distress was worsened by their lack of cooperation with the externally appointed supervisor.

4.3.2 | Limit court involvement

If court involvement is envisaged under national law and the state opts for a revised insolvency system applicable to local entity in distress, it appears sensible to give jurisdiction to the same courts responsible for company insolvency procedures. There is no need to provide courts with

additional supervisory or discretionary powers to deal with local public entities in distress, as the goal of ensuring the continuity of public services can be achieved without special powers being granted to judicial authorities. If states opt for a revised administrative framework applicable to local entities in distress, there is a case for giving jurisdiction to special administrative courts, provided that these courts already deal with all matters related to local public entities (as it happens in countries like Italy).

A corollary of the limited court involvement in these procedures is that more power should be given to independent practitioners. In the reports considered for this study, it is clear that states rely on different types of private and administrative professionals (that is, public employees) to support local entities in distress. While not advocating for uniform solutions on this matter, it may be worth exploring if existing local, independent qualified insolvency practitioners are able to efficiently and effectively support the drafting of a restructuring or liquidation plan for a local entity in distress while not adding excessive costs to the procedure.

Some countries like Belgium, Italy, and the Russian Federation, have well-established mechanisms of administrative oversight for entities in distress. If these mechanisms work well in practice, they represent a useful tool to improve the accountability of local managers and reduce the risks of moral hazard. However, we argue that such solutions may increase the complexity of the insolvency framework. As a result, we argue that it is preferable to rely on existing corporate rescue procedures and to tweak them in light of the peculiar needs of local public entities and their vulnerable stakeholders.

4.3.3 | Protect vulnerable parties and local investors

Even if local public entities are frequently rescued, deviations from the principles of collectivity and equality of treatment should not happen on an ad hoc basis. The circumstances where deviations are possible should be institutionalized in the law. The exceptions to the general procedural principles of insolvency law should be designed to protect vulnerable and non-adjusting creditors, as well as local investors. This is because—as evidenced in Section 2 of this article—'collectively'[48] taxpayers are both contributors to these entities and the beneficiaries of local services. As a result, substantive fairness requires that their interests are prioritised over those of other claimants. In no case should the implementation of 'traditional' or administrative rescue and liquidation mechanisms have the effect of not ensuring the continuity of essential and effective public services at reasonable costs for local users.

5 | CONCLUDING REMARKS

This critique has sought to draw on the rich materials the national reports have produced to provide guidance to practitioners and make recommendations for minimum standards of regulatory reform. The material is extremely varied, and it reflects the local culture of the jurisdictions considered in the study. Some jurisdictions have extremely sophisticated frameworks, which feature concepts such as the cram-down of dissenting classes of *municipal* creditors, at a time when other countries only recently or have yet to introduce such options for *corporate* creditors.

It is hoped that this analysis of the key themes covered in the national reports has gone some distance to show that, despite the policy concerns about the preservation of

value in the context of the treatment of local public entities in distress, powerful arguments can be made for the promotion of unified principles for the treatment of local public entities in distress.

Despite the significant disparities in the treatment of local public entities across national jurisdictions, we argue that there are powerful reasons not to deviate from the 'traditional' procedural pillars of collectivity and rateable treatment of creditors in dealing with the distress of these entities. However, states should implement mitigating measures to ensure the provision of essential public services at reasonable levels and costs. This is because substantive fairness plays a prominent role in the treatment of local public entities in distress, as evidenced Section 2. Domestic legislators should acknowledge that substantive fairness is a guiding principle for the treatment of local public entities in distress. They should also acknowledge that, in case of conflict with the procedural principles of collectivity and rateable treatment of creditors, the need to ensure the provision of essential services and protect the beneficiaries of such services should prevail.

Rather than suggesting an optimal or model procedure for dealing with these entities, this article leaves to national legislators the *onus* of devising principled judicial or administrative procedures for dealing with local public entities in distress. The comparative and comprehensive nature of this study may represent the starting point to promote a national (or international) debate on the strategies to be followed in reforming local laws based on the recommendations provided above.

There is no one-size-fits-all approach to dealing with the challenges discussed in this article. That is very much because the approach followed by one jurisdiction may not work well in another. For example, the question of what constitutes an 'essential' public service may well vary from jurisdiction to jurisdiction, and even from locality to locality.[49] Further, the fact remains that whether we are referring to a civil law country or a common law one, insolvency law interacts and intersects with different established laws, private and public.[50] That means any solution, whether simple or complex, is likely to produce a knock-on effect elsewhere in the wider body of law.

It is thus enriching for practitioners, policymakers and scholars of insolvency law to experiment with good practices elsewhere while keeping an eye on the wider legal tapestry. The challenges we face are global, but uniform global solutions are unlikely to be achieved in the short term and may in any case be inadequate to deal with local issues. This is the main reason we advocate that, in determining the rules applicable to local public entities in distress, domestic legislators should pursue territorial solutions based on the uniform, 'traditional' principles of collectivity and equality of treatment of creditors. Deviations from these founding pillars should be granted only when necessary to ensure the continuity of public services.

ENDNOTES

[1] This article has been adapted from a publication titled 'When liquidation is not an option: A global study on local public entities (LPEs) in distress' (INSOL International, 2022). The project was funded by INSOL International and the University of Essex. The authors are grateful to the members of the mentoring group: Professor John Bell (University of Cambridge), Professor Maurice Sunkin (University of Essex) and Professor Georg Kodek (Vienna University of Economics and Business), as well as to all the contributors in this project for their insightful comments on earlier drafts of this article. The article covers literature and case law published before 1 May 2022. The usual disclaimer applies. The jurisdictions covered in the study are (in alphabetical order): Argentina, Australia, Bangladesh, Belgium, Brazil, Canada, Croatia, France, Germany, Ghana, Italy, Japan, Netherlands, Nigeria, People's Republic of China, the Russian Federation, South Africa, Uganda, the United Kingdom and the United States of America.

[2] In the US tradition, the term 'bankruptcy' is frequently employed to refer to corporate insolvencies. Similarly, the notion of 'corporate bankruptcy' is employed as a synonym of 'corporate insolvency'. This article employs the terms 'insolvency' and 'bankruptcy' in accordance with the British terminology conventions. Any mention of bankruptcy can be taken to mean personal bankruptcy, unless in direct quotations.

[3] There is of course a great deal of literature on the method. The standard starting point is Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (translated by Tony Weir, 3rd edn, Oxford University Press, 1998). The main question for them is ensuring that what is compared is really comparable. They want to ensure that the general conclusions drawn from the comparison are really based on generalisable concepts. See also Ralf Michaels, 'The Functional Method of Comparative Law', in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (2nd edn, Oxford University Press, 2019), 345–389, who provided the following list: for the United States, John Reitz, 'How to do Comparative Law' (1998) 46 American Journal of Comparative Law 617, 620–623; Mathias Reimann, 'The Progress and Failure of Comparative Law in the Second Half of the Twentieth Century' (2003) 50 American Journal of Comparative Law 671, 679; for France, Marc Ancel, *Utilité et méthodes de droit comparé* (Ides et Calendes, 1971), 97, 101–103; Marc Ancel, 'Le problème de la comparabilité et la méthode fonctionnelle en droit comparé', in Ronald Graveson et al. (eds), *Festschrift für Imre Zajtay* (Mohr Siebeck, 1982), 1–6; for England, Hugh Collins, 'Methods and Aims of Comparative Contract Law' (1991) 11 Oxford Journal of Legal Studies 396; Peter de Cruz, *Comparative Law in a Changing World* (3rd edn, Routledge-Cavendish, 2007), 236–238; for Germany, Hein Kötz, 'Comparative Law in Germany Today' (1999) 51 Revue internationale de droit comparé 753, 755; Uwe Kischel, *Rechts-vergleichung* (Beck, 2015), 6–7, 93; for Scandinavia, Michael Bogdan, *Concise Introduction to Comparative Law* (Europa Law Publishing, 2013), 46; for a socialist perspective, Imre Szabó, 'Theoretical Questions of Comparative Law', in Imre Szabó and Zoltán Péteri (eds), *A Socialist Approach to Comparative Law* (Kluwer Academic Publishers, 1977), 9, 36–38; for the rise and fall in Italy, Pier Giuseppe Monateri, 'Critique et différence: Le droit comparé en Italie' (1999) 51 Revue internationale de droit comparé 989, 991.

[4] The functionalist method has been criticised (among others) for its objectives (imposing one solution and forcing similarities), its positivist approach, its lack of sensitivity to the context, the law in practice and culture. Among others, see Jonathan Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 Oxford Journal of Legal Studies 101; Mathias Siems, *Comparative Law* (2nd edn, Cambridge University Press, 2018), 39–48; Jaakko Husa, 'Farewell to Functionalism or Methodological Tolerance?' (2003) Rabel Journal of Comparative and International Private Law Bd. 67, H. 3, 419–447 (suggesting placing functionalism in comparative law in a legitimate but restricted position as an interesting and sometimes even fruitful, but certainly not exclusive form of comparative methodology within the field of legal studies).

[5] Mauro Bussani, 'Deglobalizing Rule of Law and Democracy: Hunting Down Rhetoric Through Comparative Law' (2019) 67(4) American Journal of Comparative Law 701.

[6] OECD, *Unlocking Infrastructure Investment: Innovative Funding and Financing in Regions and Cities* (OECD Publishing, 2021) <https://doi.org/10.1787/9152902b-en>.

[7] Esin Örücü, 'Methodological Aspects of Comparative Law' (2006) 8(1) European Journal of Law Reform 29, 33.

[8] Elizabeth Warren, 'Bankruptcy Policy' (Summer 1987) 54(3) University of Chicago Law Review 775; Elizabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Michigan Law Review 336; Karen Gross, 'Taking Community into Account in Bankruptcy: An Essay' (1994) 72 Washington University Law Quarterly 1031. For an outline of the different visions of corporate insolvency law, see, inter alia: Vanessa Finch, 'The Measures of Insolvency Law' (Summer 1997) 17(2) Oxford Journal of Legal Studies 227, 230–242; Eugenio Vaccari and Emilie Ghio, *English Corporate Insolvency Law: A Primer* (Edward Elgar Publishing, 2022), Chapters 1–2.

[9] John Rawls, *Justice as Fairness. A Restatement* (3rd edn, Harvard University Press, 2003); Irit Mevorach, 'Equitable Distribution and Accountability' in Irit Mevorach (ed), *Insolvency within Multinational Enterprise Groups* (Oxford University Press, 2009) (arguing that insolvency law should be concerned with fairness in distribution); Max Radin, 'Fair, Feasible and in the Public Interest' (1941) 29(4) California Law Review 451, 454–455; Alexander Cappelen et al., 'Fairness in Bankruptcies: An Experimental Study' (2019) 65(6) Management Science 2832; Riz Mokal, 'On Fairness and Efficiency' (2003) 66 Modern Law Review 452; Sarah Paterson, 'Debt Restructuring and Notions of Fairness' (2017) LSE Research Paper, 2, <http://eprints.lse.ac.uk/68559/1/Debt_restructuring_author.pdf>.

[10] People and companies differ in their resilience towards external disrupting factors, such as failure. According to vulnerability theories, legislative frameworks should be geared towards protecting non-adjusting vulnerable creditors rather than non-vulnerable ones. For an outline, see: Jennifer Gant, 'Optimising fairness in insolvency and restructuring: A spotlight on vulnerable stakeholders' (2022) 31(2) International Insolvency Review 1. For a more general outlook to vulnerability theories, see: Martha Fineman, 'The Vulnerable Subject: Anchoring Equality in the Human Condition' (2008) 20(1) Yale Journal of Law and Feminism 1; Martha Fineman, 'Vulnerability and Inevitable Inequality' (2017) 4(3) Oslo Law Review 133, 135. For an application of these theories to the field of corporate insolvency law, see: Daniel Korobkin, 'Vulnerability, Survival, and the Problem of Small Business Bankruptcy' (1994) 23(2) Capital University Law Review 413.

[11] Eugenio Vaccari, 'Broken Companies or Broken System? Charting the English Insolvency Valuation Framework in Search for Fairness' (2020) 35(4) Journal of International Banking Law and Regulation 135. For an implementation of this theoretical framework, see: Eugenio Vaccari, 'Promoting Fairness in English Insolvency Valuation Cases" (2020) 29(2) International Insolvency Review 285.

[12] Sarah Paterson, 'Debt Restructuring and Notions of Fairness' (2017) 80(4) Modern Law Review 600.

[13] Edward Zajac, *Political Economy of Fairness* (MIT Press, 2001), 120.

[14] Matthew Glasser and Johandri Wright, 'South African municipalities in financial distress: what can be done?' (2020) 24 Law Democracy & Development 413.

[15] Borrowed from the law and economics literature, the 'common pool' metaphor suggests that the fishermen who fish at a single 'pool' may fish too much and deplete the pool, if they cannot bargain with each other to limit their activity. It would be in the general interest of each fisherman to limit their fishing practice: in the long run, this would result in a higher return for them (because fish would be allowed to procreate and multiply). On the other hand, selfish, short-term practices would lead to over-fishing, for fear that others will do the same. See: Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (2nd edn, Harvard University Press, 2001), 11–12.

[16] Jackson (n 15), 10, 12–14.

[17] Traditional common pool problems are complemented by other types of problems, such as semi-commons (Henry Smith, 'Semicommon Property Rights and Scattering in the Open Fields' (2000) 29 Journal of Legal Studies 131) and anti-commons (Michael Heller, 'The Tragedy of the Anticommons: Property in the Transition from Marx to Markets' (1998) 111(3) Harvard Law Review 621); Lee Anne Fennell, 'Commons, Anticommons, Semicommons' (2009) University of Chicago Public Law & Legal Theory Working Paper No. 261/2009, 9–16 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1065&context=public_law_and_legal_theory>; Rolef de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two common Problems: Common Pool and Anticommons' (2012) 21 International Insolvency Review 67.

[18] Jackson (n 15), Chapters 1–2; Laura Coordes, 'Bespoke Bankruptcy' (2021) 73 Florida Law Review 359, 366.

[19] Vincent Buccola, 'Law and Legislation in Municipal Bankruptcy' (2017) 38 Cardozo Law Review 1301, 1306.

[20] However, for arguments claiming that the *pari passu* principle should not be treated as a fundamental principle, see Riz Mokal, 'Priority as Pathology: The *Pari Passu* Myth' (2001) 60(3) Corporate Law Journal 581.

[21] For a more detailed analysis on this point, see, inter alia: Eugenio Vaccari, "A Modular Approach to Restructuring and Insolvency Law: Executory Contracts and Onerous Property in England and Italy" (2022) 31(5) Norton Journal of Bankruptcy Law and Practice (West) 534.

[22] See n 8.

[23] Sarah Paterson, *Corporate Reorganization Law and Forces of Change* (Oxford University Press, 2020).

[24] These clauses provide to the innocent party a quasi-security right over the debtor's assets. Examples of such clauses include retention of title clauses, hire-purchase agreements, and similar. Where permitted under the law, termination and other types of *ipso facto* clauses also provide preferential treatment for the innocent party. For a global analysis of these clauses, see: Jason Chuah and Eugenio Vaccari (eds), *Executory Contracts in Insolvency Law: A Global Guide* (Edward Elgar Publishing, 2019).

[25] Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press, 1997); Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press, 2017); Warren, 'Bankruptcy Policy' (n 8).

[26] Warren, 'Bankruptcy Policy' (n 8). For the other side of the debate, see: Douglas Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54(3) University of Chicago Law Review 815.

[27] Chrystin Ondersma, 'Overlooked human rights concerns in the restructuring and insolvency context' in Paul Omar and Jennifer Gant (eds), *Research Handbook on Corporate Restructuring* (Edward Elgar Publishing, 2021).

[28] As explained later (see n 45), the taxpayers who 'rescue' a local entity in distress may not entirely overlap with those who benefit from its services.

[29] Local public entities can be rescued through a variety of mechanisms (such as a bail out by higher governmental authorities, a liquidation of their assets, a merger with other authorities, an increase in taxes and reduction of activities) or—more frequently—a combination of them. It is intended that further research by the authors will analyse the impact and effectiveness of each of these mechanisms, as well as the desirability of alternative approaches for devising long-term solutions to the problems of local public entities in distress.

[30] For Netherlands, this categorisation is valid only with reference to basic local public entities. In this country, basic entities can have access to 'traditional' insolvency procedures. However, they never file for such procedures due to the presence of a well-developed comprehensive administrative system. Hybrid entities can and do file for traditional insolvency procedures.

[31] For example, in the United States, intergovernmental (primarily state) aid may be a significant source of local public entity revenue. Laura Coordes and Thom Reilly, 'Predictors of Municipal Bankruptcies and State Intervention Programs: An Exploratory Study' (2016–2017) 105 Kentucky Law Journal 493, 505.

[32] Please note that Article 212, Russian Civil Code, expressly provides that private, state, municipal and other forms of property are recognised in the Russian Federation. As a result, local public entities can and do own assets.

[33] For England: Yseult Marique, *Public-Private Partnerships and the Law: Regulation, Institutions and Community* (Edward Elgar Publishing, 2014).

[34] Such concern was not raised in the Dutch report. In comments to a draft version of this article, the Dutch commentators observed that the oversight carried out by the Provincial executive is independent, transparent, and compliant with a national framework (*gemeenschappelijk toetsingskader*). Besides this financial investigation, the commentators observed that there are other independent financial checks under Dutch law, including from external accountants, which ensure the independence and transparency of this assessment.

[35] David Milman, 'The rise of the objective concept of 'unfairness' in UK company law' (2010) 286 Company Lawyer 1, 1.

[36] The importance of this principle is also recognised at the international level: Council of Europe, 'Recommendation No. R (97) 7 of the Committee of Ministers to Member States on Local Public Services and the Rights of their Users' <https://rm.coe.int/16804c68f6> (see, in particular, Principle 3 "continuity of essential services").

[37] Italy, for instance, adopts a unitary definition of 'local public entity'.

[38] Randal Picker and Michael McConnell, 'When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy' (1993) 60 University of Chicago Law Review 425, 427.

[39] On this matter, see Article 4(1)(a), Regulation 2019/452 of the European Parliament and of the Council of March 19, 2019 establishing a framework for the screening of foreign direct investments into the Union [2019] OJ L 79I, holding that 'critical infrastructure, whether physical or virtual, [includes] energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure'.

[40] On this purpose, see Articles 10–11. United Nations Convention Against Corruption (New York, 2004).

[41] Conditionality Regulation 2020/2092 of the European Parliament and of the Council of 16 December, 2020 on a general regime of conditionality for the protection of the Union budget OJ L 433I (22 December 2020), 1–10, notably Recital 8, Articles 2(b) [scope of application] and 4(1) about addressing breaches with a 'seriously risk [of] affecting the sound financial management of the Union budget or the protection of the financial interests of the Union'.

[42] We acknowledge that this principle may be controversial, especially for states such as Germany that have included in their Constitutions the principle of 'continuity of municipal entities' (Article 28(2), German

Constitution). This article does not secure the existence of an individual municipality. In principle, care must be taken to ensure that the needs of the community can be met. However, this could also be done by reorganizing the administrative tasks as a result of the entity's reorganisation or merger with a different one.

[43] For Netherlands, this is limited to hybrid local public entities. As mentioned above, basic entities could in theory be liquidated but in practice, they are subject to special administrative provisions designed to restructure their debt and ensure the continuity of public services.

[44] The Italian commentator observed that mergers may result in entities changing their legal status.

[45] This is despite the existence of risks associated with mergers, such as more bureaucracy and less ability to tailor the service to the needs of the local population (among others).

[46] This is, for instance, what happened in the case of the collapse of Carillion, a public company involved in many public procurement contracts: Kalyeena Makortoff, 'KPMG to be fined £14 m for forging documents over Carillion audit' (*The Guardian*, 12 May 2022) <https://www.theguardian.com/business/2022/may/12/kpmg-fined-frc-audit-carillion>.

[47] However, this limitation is controversial, as the Russian Constitutional Court held in 2020 that such provision is unconstitutional to the extent that it excludes liability of the owner (e.g., state, municipality) of the liquidated budget institution for its obligations arising from a public contract.

[48] The word 'collectively' is used to show that there might not necessarily be direct symmetry between taxpayers who rescue a local entity and taxpayers who benefit from its services. If state funds are used to rescue such entity, taxpayers from different entities will contribute to the provision of services they never use.

[49] Michelle Anderson, 'The New Minimal Cities' (2014) 123 Yale Law Journal 1118–1223.

[50] Jean-Bernard Auby, 'Public/Private', in Peter Cane et al. (eds), *The Oxford Handbook of Comparative Administrative Law* (Oxford University Press, 2020), 467–480.

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