

Why this research?

COVID-19, a decreasing population, rampant inflation and rising costs related to social care, transport and utility mean that an increasing number of local public entities find themselves unable to meet their contractual obligations. Yet, the treatment of local public entities in distress is a significantly under-researched area of insolvency and public law, particularly outside the USA.



Goals:

- (1) Identify strategies for reducing or at least controlling political interferences and risks;
- (2) Learn lessons from developing and developed, small and large countries alike;
- (3) Develop unifying principles and standards for the laws and regulations governing the financial distress of these entities.

Countries:

Argentina, Australia, Bangladesh, Belgium, Brazil, Canada, Croatia, France, Germany, Ghana, Italy, Japan, the Netherlands, Nigeria, People's Republic of China, the Russian Federation, South Africa, Uganda, UK and USA.

What is this research about?

- (1) Identify 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;
- (2) Identify when and to what extent it is possible to deviate from the fundamental principles of collectivity and equal treatment of creditors in insolvency for the purpose of ensuring substantive fairness, protection of vulnerable users and local investors, and the predictability of the framework.

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<https://royalholloway.ac.uk/research-and-teaching/departments-and-schools/law-and-criminology/research/our-projects-and-research-impact/when-liquidation-is-not-an-option-lpes-in-distress/>



When Liquidation is NOT an Option?

The Treatment of Local Public Entities in Distress

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Classifications

Local Public Entities:

- (1) "basic" local public entities include municipalities, cities, districts, councils, provinces, and other political sub-divisions;
- (2) "hybrid" local public entities include any publicly or privately owned entities (including corporations) that carry out fundamental services or are responsible for the production or distribution of essential goods at a local (territorial or regional) level.

Frameworks:

- (1) **COMPREHENSIVE SPECIAL INSOLVENCY SYSTEMS.** These countries have special insolvency rules applicable to local public entities in distress or insolvent;
- (2) **COMPREHENSIVE ADMINISTRATIVE SYSTEMS.** These countries allow their entities to have access to comprehensive administrative procedures designed to ensure the continuity of public services;
- (3) **FRAGMENTED OR SPECIAL ADMINISTRATIVE SYSTEMS.** These countries have enacted some special rules designed to deal with the entity's distress in an orderly manner (but no insolvency rules);
- (4) **LIGHT-TOUCH APPROACHES TO DISTRESSED LOCAL ENTITIES.** These countries 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 the financial support from higher-ranking entities or central authorities.

Findings/Positives

- systems where local entities enjoy tax collection powers grant more autonomy and allow for longer-term planning over indirect transfers from central authorities;
- some countries (e.g. Italy, South Africa) adopt comprehensive modular approaches to the treatment of local public entities in distress, ensuring more long-term financial stability (on paper) to these entities;
- some countries (e.g. Belgium) have mechanisms to deal with financial distress at early stages with incentives to mergers between local entities in distress;
- some entities may not dispose of those capital assets needed to provide basic municipal services;
- the distress of local entities is usually dealt with through collective procedures designed to ensure the provision of essential services and their continuity.



Findings/What to Improve

- lack of coordination in domestic strategies for dealing with local public entities in distress;
- few incentives to deal with financial distress at early stages, particularly where the consequence of reporting financial issues is the displacement of the current management;
- lack of effective accountancy rules and of comprehensive provisions on the investigation of the conduct of the entity's officials;
- state intervention through buyouts in which local authorities are ultimately not accountable for their debt;
- general prohibition of liquidating local entities may not necessarily be needed to ensure the protection of vulnerable users and the continuity of local services.



Recommendations

General Recommendations

- *Introduce a unitary definition of "local public entity"*
- *Limit political interference*
- *No one-size-fits-all approach*

Guiding Principles

- *Strengthen the corporate governance framework*
- *Allow for the use of modular rescue and liquidation options, regulated either by insolvency or administrative laws*
- *Deal with financial distress in a proactive manner*

Procedural Recommendations

- *Support and train existing management*
- *Use management displacing measures only as an extrema ratio*
- *Limit court involvement*
- *Protect vulnerable players and local investors*