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TOWARD A MODEL LAW FOR THE TREATMENT OF DISTRESSED LOCAL PUBLIC ENTITIES

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INTRODUCTION

This article provides a rationale for a potential model law for the treatment of distressed local public entities (LPEs). Building upon our previous work, a first-of-its-kind global study of the treatment of LPEs in distress[1], we contend that a model law for LPE distress should take a modular approach, outlining alternative options that can be tailored to different jurisdictions' distinct legal traditions and cultures.[2] Although most of the countries in our study do not have a comprehensive system in place to address LPE distress, the commonalities that emerged across the jurisdictions studied can provide a foundation to support a model law in this area. While we leave the task of drafting a model law to future work, this article moves the discussion forward by articulating the principles, gleaned from our study, that should guide the creation of a model law on this subject.

A model law for the treatment of distressed LPEs will have significant value because countries that lack a comprehensive framework for addressing these cases subject their LPEs, and the communities and creditors that depend on and invest in them, to heightened risks and hardship. Currently, the treatment of distressed LPEs varies from country to country, and most countries lack such a comprehensive framework. In many countries, the lack of a comprehensive system for addressing LPE distress means that, in practice, higher-level governmental authorities intervene in an ad hoc and disorganized fashion whenever distress occurs.[3] A model law will provide a

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1. INSOL INT'L, WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS (2022)

2. For example, different options may be necessary depending on the structure of government and the governing model in each jurisdiction.

3. *See, e.g.*, Elizabeth Streten, *Local Public Entities in Distress – A Critical Analysis of the Australian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 50, 61 [hereinafter *Australia Report*] ("While there are community complaint mechanisms and general community reporting . . . it is ultimately the politicians

roadmap of best practices for jurisdictions to consider. Adoption of these best practices would bring more clarity, consistency, and legal certainty to the treatment of distressed LPEs, allowing investors and other creditors to better understand and mitigate the risks of lending to an LPE.

LPEs play a critical role in state economies.[4] When they experience financial distress or insolvency, risk abounds to members of the local community, who risk deprivation of essential public services; to nearby regions, which risk the effects of contagion;[5] and to investors, who risk a loss or diminution of their investment. Due to the rich variety of activities in which LPEs are engaged, and the various ways in which they contribute to the quality of public life, LPE distress can create systemic risks.[6] Consequently, a comprehensive system for addressing LPE distress should be a part of any jurisdiction's legal system. In this way, investors, creditors, the public, and all those who interact with or receive services from an LPE can clearly understand how the distress of that LPE will be handled and can take steps to mitigate risks relating to LPEs.

who action concerns pertaining to financial distress of local governments."); Eugenio Vaccari & Yseult Marique, *Local Public Entities in Distress – A Critical Analysis of the English Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 156, 170 [hereinafter *England Report*] ("CFOs have the power and legal responsibility to suspend a local authority's spending for a period of time if they consider the council to not have a balanced budget or if there is an imminent prospect of default."); Stephanie Ben-Ishai, *Local Public Entities in Distress – A Critical Analysis of the Canadian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 124, 130-31 [hereinafter *Canada Report*] (describing restrictions on municipalities and their financial activities as differing from province to province); Sergio Díaz Ricci, Gabriela Ábalos, & Héctor José Miguens, *Local Public Entities in Distress – A Critical Analysis of the Argentinian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 35, 37 [hereinafter *Argentina Report*] (noting that the "provincial constitutions dictate the competences, organisation, categories, and other matters regarding municipalities"); Iyare Otabor-Olubor & Anthony Idigbe, *Local Public Entities in Distress – A Critical Analysis of the Nigerian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 279, 288 [hereinafter *Nigeria Report*] (describing a "lack of any formal means of legislative insolvency or restructuring resolution framework for local public entities" and noting that "[i]t is also not uncommon to find the federal government having to intervene by issuing bailout funds to states and local public entities by extension").

4. *See, e.g.*, TONY TRAVERS, LOCAL GOVERNMENT'S ROLE IN PROMOTING ECONOMIC GROWTH: REMOVING UNNECESSARY BARRIERS TO SUCCESS (2012), https://eprints.lse.ac.uk/47842/ [https://perma.cc/7XMM-AM56].

5. *See, e.g.*, Pengjie Gao et al., *Municipal Borrowing Costs and State Policies for Distressed Municipalities*, 132 J. FIN. ECON. 404, 405 (2019) ("A common concern in municipal bond markets is the contagion effect . . . ."). *But see* Susan K. Urahn et al., *The State Role in Local Government Financial Distress*, PEW CHARITABLE TRS. 13 (2013), https://www.pewtrusts.org/~/media/assets/2016/04/pew_state_role_in_local_government_financial_distress.pdf [https://perma.cc/ZJV7-STZW] (noting that "the actual threat [of contagion] can be overstated").

6. Urahn et al., *supra* note 5, at 13 (noting that states can be motivated to involve themselves in resolving municipal distress in order to avoid "service interruptions, especially those threatening public safety and health").

Although future work will develop the exact contours of a model law for distressed LPEs, this article lays the groundwork for such a law. Drawing upon original research of the treatment of distressed LPEs in twenty jurisdictions around the world, this paper demonstrates the value of a model law and outlines some key features and guiding principles to consider for its development.

The article proceeds as follows. Part I describes the current treatment of LPEs in distress, drawing heavily on information collected from our study. Part II examines the consequences flowing from current approaches to distressed LPEs. Using specific examples, Part II illustrates that many current approaches create commercial uncertainty and legal unpredictability. Yet, as divergent as these approaches are, they share some common goals: collectivity, continuity of essential public services, and protection of vulnerable stakeholders. In Part III, we outline our proposals for the guiding principles behind a model law for distressed LPEs and illustrate the extent to which these proposals are aligned with the insolvency principles articulated by the United Nations Commission on International Trade Law (UNCITRAL) with respect to insolvencies more generally. We do this to show that, at bottom, LPE distress is not so different from the insolvency or distress of other entities and, consequently, a model law will be useful in the LPE distress context, much as UNCITRAL's model laws are useful in the general insolvency law context. Part III also identifies and addresses some concerns and challenges that may be raised in response to the development of a model law. Part IV concludes.

I. CURRENT TREATMENT OF DISTRESSED LPES

This Part describes how countries around the globe currently address LPE distress. Subpart A introduces our study, defines key terms, and describes our research design and methodology. Subpart B provides an overview of our key findings.

A. Background and Research Design

Our study defines a "local public entity" as "a public authority or entity partially or totally funded by tax levies," which "provides public services, namely essential services with a collective or social dimension . . . not necessarily or not always at market price, to local communities."[7]

7. Laura N. Coordes et al., *Collectivity and Equality (*Pari Passu*) in the Treatment of Local Public Entities in Distress*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 1, 1 [hereinafter *Study Introduction*].

We further distinguish between "basic" and "hybrid" LPEs. A basic LPE is equivalent to a general-purpose municipality in the United States and includes entities such as "municipalities, cities, districts, councils, provinces, and other political sub-divisions" of a state or country.[8] A hybrid LPE is a publicly or privately owned entity that carries out fundamental services or that is responsible for the production or distribution of essential goods at a local, territorial, or regional level.[9] Hybrid LPEs share two characteristics that distinguish them from other entities: (1) as stated, they must carry out a public service and mission; and (2) "another local authority or municipality must ultimately be responsible, legally or politically, for all or part of their debts."[10] Included among hybrid LPEs are entities such as water districts, housing authorities, sewer districts, transportation districts, energy authorities, and public hospitals.

What these definitions make clear is that LPEs are connected to numerous facets of everyday life for individuals around the world. Given the number and variety of LPEs, they also represent—through their funding and expenditures—a significant amount of public money. For example, a 2019 study found that state and local government expenditures in the United States amounted to $2.9 trillion.[11] Their relevance is not restricted to their institutional investment capacity. In fact, the same study noted that "state and local governments make key investment decisions—about infrastructure, education, and many other areas—that help determine the long-run capacity of the entire economy."[12] Accordingly, an LPE's distress or failure not only may disrupt the immediate community that the LPE serves but also may have ripple effects on local, regional, or even national economies.[13]

To better understand the treatment of distressed LPEs around the world, our INSOL International-funded study collected information from four geographic regions: Europe, Asia, Africa and the Middle East, and the Americas. In total, the project covered twenty jurisdictions and drew upon the work of

8. *Id.*

9. *Id.* at 1-2.

10. *Id.* at 2.

11. Ryan Nunn et al., *Nine Facts About State and Local Policy*, BROOKINGS 1, 1 (2019), https://www.brookings.edu/wp-content/uploads/2019/01/StateandLocal_Facts_Web_20190128.pdf [https://perma.cc/Y7H5-TA5T].

12. *Id.*

13. Urahn et al., *supra* note 5, at 11-12 (describing officials in Michigan who rejected the municipality of Hamtramck's request for bankruptcy protection out of concern for the "ripple effect" it could have on other local governments and the state of Michigan itself); Laura N. Coordes, *Formalizing Chapter 9's Experts*, 116 MICH. L. REV. 1249, 1281 (2018) ("[M]unicipalities are complicated, multifaceted entities whose distress can create ripple effects extending well beyond the distressed entity itself.").

twenty-three contributors and the expertise of the three principal investigators.

We initially asked contributors to complete a questionnaire for their jurisdiction. The questionnaire was divided into three broad sections, asking contributors to describe: (1) the general context of insolvency law in their jurisdiction; (2) the existing legal framework, if any, for dealing with LPE distress; and (3) examples, if any, of how the law works in practice to resolve LPE distress. The principal investigators and contributors then met virtually for progress meetings to discuss the findings from the questionnaires and to allow the contributors to share additional information. Following these conferences, the contributors wrote reports for their jurisdictions (the "National Reports") based on their answers to the questionnaires and subsequent discussion and research.

Upon receiving and reviewing all the National Reports, the principal investigators generated a series of recommendations for the treatment of distressed LPEs. These recommendations formed the basis for this project's initial paper, *Collectivity and Equality (*Pari Passu*) in the Treatment of Local Public Entities in Distress*, published along with the National Reports in INSOL International's Technical Library in the Fall of 2022 and, in a slightly amended form, in the *International Insolvency Review*.[14] This article follows directly from that paper, building upon its recommendations to formulate guiding principles for the development of a model law for the treatment of distressed LPEs.

In making the recommendations that follow, we recognize that diverse political, legal, and cultural backgrounds may result in different countries taking different approaches to otherwise similar problems.[15] For this reason, the approach we recommend is modular, as we understand that different tools may be needed depending on the country and the situation.[16] Before we turn to those recommendations, however, we provide an overview and analysis of our study results.

14. Laura N Coordes, Yseult Marique & Eugenio Vaccari, *Global Trends in the Treatment of Local Public Entities in Distress: A Principled Approach*, 32 INT'L INSOLVENCY REV. 93 (2023).

15. *Study Introduction*, *supra* note 7, at 4 (observing that our study recognizes "that different legal backgrounds may approach similar problems in unique manners").

16. For a detailed analysis of the concept of a "modular approach" to the design of bankruptcy procedures, see for example RIZ MOKAL ET AL., MICRO, SMALL AND MEDIUM ENTERPRISE INSOLVENCY: A MODULAR APPROACH (2018); Eugenio Vaccari, *A Modular Approach to Restructuring and Insolvency Law: Executory Contracts and Onerous Property in England and Italy*, 31 NORTON J. BANKR. L. & PRAC. 534 (2022).

B. Existing Approaches to Addressing LPE Distress

Through our study, we observed vastly dissimilar treatment of distressed LPEs from one jurisdiction to the next. Nevertheless, we were able to group the existing approaches into four categories:[17]

1. Comprehensive special insolvency systems. In these countries, a special insolvency framework applies to distressed or insolvent LPEs. The United States was the only country in our study to fall within this category. Its special insolvency framework is Chapter 9 of the United States Bankruptcy Code (hereinafter, "Chapter 9").[18]
2. Comprehensive administrative systems. These countries do not allow LPEs to access insolvency procedures but do allow them to access comprehensive administrative procedures designed to ensure the continuity of public services. In general, these administrative procedures are highly detailed, thus lessening the need for higher-level intervention such as bailout, at least on paper. Belgium, Brazil, Italy, Japan, the Netherlands (for basic LPEs only), and South Africa all fall within this category.
3. Fragmented or special administrative systems. These countries do not allow LPEs access to insolvency procedures but do subject distressed LPEs to some special rules that are designed to address their distress in an orderly manner. These rules tend to be fragmented in nature; consequently, higher-level intervention via bailout is likely if the LPE is facing serious distress or insolvency. Conditions for higher-level intervention are generally discretionary. Australia, France, Germany, the People's Republic of China (for state-owned enterprises only), the Russian Federation, and the United Kingdom all fall within this category.
4. Light-touch approaches to distressed local entities. These countries lack a special set of rules applicable to distressed LPEs while not allowing their LPEs to access insolvency procedures. Instead, distressed LPEs are generally dealt with via informal workouts with creditors or through higher-level financial support. Argentina, Bangladesh, Canada, Ghana, Nigeria, the People's Republic of China (for public entities), and Uganda all fall within this category.

17. For a more fulsome discussion of each of these categories, see *Study Introduction*, *supra* note 7, at 10-15.

18. 11 U.S.C. §§ 901-946.

II. CONSEQUENCES FLOWING FROM CURRENT APPROACHES TO DISTRESSED LPES

In addition to broadly categorizing the existing treatment of distressed LPEs in the jurisdictions we observed, our study revealed the practical impacts of the various systems. This Part draws upon specific examples from the National Reports we compiled and reviewed to illustrate the various consequences—both positive and negative—flowing from the current, patchwork approaches to treatment of distressed LPEs.

A. Uncertainty

Uncertainty in the distressed LPE context takes many forms. Indeed, we observed at least three types of uncertainty from the different treatment of distressed LPEs across jurisdictions.

First, uncertainty exists as to what an LPE is and, relatedly, which authority defines an LPE. Many countries do not provide a single definition of an LPE.[19] Instead, different definitions may be used by different levels or branches of government. For example, in the United States, the definition of "municipality" in the U.S. Bankruptcy Code differs from the way individual states define "municipality."[20] In still other cases, such as Ghana, the law fails to distinguish LPEs from local governments.[21]

The existence of hybrid LPEs and public-private partnerships further complicates matters. For example, both the United States and England have relied extensively on public-private partnerships to deliver services to local communities.[22] However, it is often unclear whether entities issuing debt pursuant to these partnerships should be classified under the law as LPEs or as private entities. Consequently, there is a lack of clarity and certainty as to

19. *See, e.g.*, *Canada Report*, *supra* note 3 at 129 ("There is no single definition of a 'public entity' at any level of government in Canada.").

20. *Compare* 11 U.S.C. § 101(40) (defining "municipality" as "political subdivision or public agency or instrumentality of a State"), *with* FL. STAT. § 180.01 (2023) (defining "municipality" as "any city, town, or village duly incorporated under the laws of the state").

21. Kenneth NO Ghartey, *Local Public Entities in Distress – A Critical Analysis of the Ghanaian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 202, 207 ("There is no distinct concept of a local public entity under the Ghanaian constitutional architecture and in other law.").

22. For England, see YSEULT MARIQUE, PUBLIC-PRIVATE PARTNERSHIPS AND THE LAW: REGULATION, INSTITUTIONS AND COMMUNITY (2014); for the United States, see Michael Della Rocca, *The Rising Advantage of Public-Private Partnerships*, MCKINSEY & CO. (July 19, 2017), https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/the-rising-advantage-of-public-private-partnerships [https://perma.cc/NB9U-7VG3] ("In the United States, governments are increasingly turning to public-private partnerships (P3s) to implement public infrastructure works.").

whom is ultimately responsible for their debt and as to whether and how public-private and similar entities will be able to access relief upon experiencing insolvency or other distress.[23]

Second, even if relief is available to LPEs, there is uncertainty as to whether any particular LPE will qualify for available relief.[24] Even where LPEs are defined, confusion can still result. For example, U.S. law is still highly unsettled when it comes to determining whether an entity qualifies for Chapter 9 bankruptcy relief, even though "municipality" is defined in the U.S. Bankruptcy Code and even though U.S. courts have employed various multi-factor tests to determine the results in particular cases.[25]

Finally, uncertainty exists as to whether, when, and how a higher-level authority might intervene to rescue a distressed LPE. This uncertainty is heightened in countries that lack a comprehensive framework for addressing LPE distress or other guidelines for government intervention. When an LPE becomes insolvent in one of these jurisdictions, there is a risk that a higher-level authority will intervene on an ad hoc basis, using taxpayer money to bail out the LPE or, when a complete bailout is not possible due to the authority's own financial constraints or otherwise, to favor certain creditors over others. For example, in Nigeria, which lacks special insolvency procedures for LPEs, the central government often intervenes to bail out local entity debts; however, such intervention cannot be counted on, leading Nigerian LPEs to develop their own "survival strategies."[26]

Even in jurisdictions where a framework does exist, the political and practical situation on the ground may still result in ad hoc or politicized higher-level government intervention.[27] Because politics is inevitably

23. Peter J. Benvenutti et al., *An Overview of Chapter 9 of the Bankruptcy Code: Municipal Debt Adjustments*, JONES DAY, (Aug. 2010), https://www.jonesday.com/en/insights/2010/08/an-overview-of-chapter-9-of-the-bankruptcy-code-municipal-debt-adjustments [https://perma.cc/TY3P-4TTQ] (observing that, in one U.S. case, a possible dismissal of the case under Chapter 11 "may therefore . . . be tantamount to denial of access to the Bankruptcy Code in its entirety").

24. *See, e.g.*, *id.* ("The structure and purpose of many projects financed using so-called 'conduit' or 'special revenue' financing has, in some cases, blurred the line between a private entity, eligible for chapter 11, and a municipality, eligible only for chapter 9.").

25. *See, e.g.*, *In re* Las Vegas Monorail Co., 429 B.R. 770, 783 (Bankr. D. Nev. 2010) ("[C]aselaw . . . evolved to recognize that entities created to facilitate public financing of infrastructure projects might not themselves be municipalities."); Matthew A. Bruckner, *Special Purpose Municipal Entities and Bankruptcy: The Case of Public Colleges*, 36 EMORY BANKR. DEV. J. 341 (2020) (discussing the existing case law).

26. *Nigeria Report*, *supra* note 3, at 288-89 ("It is also not uncommon to find the federal government having to intervene by issuing bailout funds to states and local public entities by extension.").

27. *See, e.g.*, Geo Quinot, *Local Public Entities in Distress – A Critical Analysis of the South African Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 326, 345 [hereinafter *South Africa Report*] (criticizing interventions by provincial governments and concluding that, due to practicalities, "it does not seem that the dedicated legal framework for assisting LPEs in distress is particularly successful").

intertwined with municipal distress, the political situation and political perceptions may unduly influence the treatment of distressed LPEs in practice, regardless of the laws on the books.

Uncertainty has negative consequences for LPEs, their creditors, and the overall economy. In other words, legal uncertainty translates into commercial uncertainty. If it is not clear whether an entity qualifies as an LPE, or if the only realistic relief available comes from sporadic, unreliable, and incomplete intervention from a higher-level authority, creditors may be hesitant to lend to LPEs. They may charge higher interest rates for loans, ask for additional guarantees or demand collateral to secure their loans. This may result in LPEs themselves experiencing difficulties in raising capital to provide public services. Furthermore, the lack of clarity surrounding the definition and remit of LPEs brings uncertainty to those who interact with, lend to, and invest in LPEs. The circumstance that LPE relief is typically distinct from relief provided to distressed companies further raises doubts for potential investors.

B. Divergent Approaches to LPE Governance

There is drastic variation in terms of what LPEs must report to higher-level authorities and the accounting and financial standards LPEs are held to. In some countries, such as Belgium,[28] Canada,[29] and Japan,[30] at least some LPEs must conform to strict accounting and reporting rules and restrictions. In other countries, such as the United States, there is substantial variation among the states as to what municipalities and other local entities must report.[31] In England, there are incentives *not* to disclose ongoing

28. Steven Van Garsse & Ellen Wouters, *Local Public Entities in Distress – A Critical Analysis of the Belgian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 93, 102 [hereinafter *Belgium Report*] ("Local administrations in Flanders are subject to a reporting obligation. They must demonstrate financial and structural balance.").

29. *Canada Report*, *supra* note 3, at 131 ("Provinces do, however, routinely place restrictions on municipalities and their institutions regarding how they can raise debt.").

30. Keisuke Imamoto, *Local Public Entities in Distress – A Critical Analysis of the Japanese Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 232, 243 [hereinafter *Japan Report*] ("The heads of local governments are required to report and disclose on an annual basis the ratio for determining [financial] soundness . . . .").

31. Laura N. Coordes, *Local Public Entities in Distress – A Critical Analysis of the US Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 362, 364–65 [hereinafter *U.S. Report*] ("The extent of a state's oversight of an LPE's finances varies depending on the state and on the entity type.").

financial difficulties, because doing so would lead to increased supervision and possibly replacement of management.[32]

If an LPE falls into distress, countries vary in terms of the range of permissible activities an LPE can engage in. Countries sometimes allow distressed LPEs to dissolve, liquidate or—more frequently—merge. A primary concern is when an LPE is dissolved unnecessarily due to poor oversight or intervention. For example, there were several instances in England where higher-level oversight resulted in the possibly unnecessary dissolution of the LPE.[33] Australia and Belgium are prominent examples of countries that proactively allow for the merger of LPEs, with Belgium even providing incentives for merger: if distressed entities jointly propose a merger, they may be eligible for a partial bailout from regional governments.[34] In other countries, however, merger or liquidation may be legally or practically difficult.[35]

States take varying approaches to the monitoring of LPEs within their boundaries and to retention of management when an LPE experiences distress or becomes insolvent. Belgian law, for example, provides for "special oversight" and limited powers for higher-ranking entities to make decisions on behalf of local authorities.[36] Some U.S. states have laws providing for the appointment of emergency managers or oversight boards when an LPE falls into distress.[37] In Japan, higher-level authorities use a system of yellow and red "cards" to determine whether they should displace local management, with the amount of intervention escalating as the level of distress rises.[38]

We also observed a lack of coordination even within domestic approaches to LPE governance. For example, South Africa subjects LPEs to

32. *England Report*, *supra* note 3, at 169 ("[T]here are perverse incentives associated with not disclosing any ongoing financial difficulties, as disclosure would lead to the disclosing local authority's existing management being supervised and eventually replaced by independent commissioners appointed by the Government.").

33. *Study Introduction*, *supra* note 7, at 16 (noting that cases of oversight resulting in dissolution "were recorded in the UK, while in Australia there is legislative power to merge local authorities").

34. *Australia Report*, *supra* note 3, at 62 ("There have been numerous amalgamations of council areas in [New South Wales] . . . ."); *Belgium Report*, *supra* note 28, at 100 ("Municipalities that jointly propose a merger can, in principle, enjoy a reduction in their debts.").

35. *See, e.g.*, Hamiisi Junior Nsubuga, *Local Public Entities in Distress – A Critical Analysis of the Ugandan Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 347, 360 ("The lack of experienced professional capable of effecting a merger or reorganisation by means of a scheme led the parties to look for alternative solutions . . . .").

36. *Belgium Report*, *supra* note 28, at 101 (discussing differences between general and special oversight).

37. *See, e.g.*, MICH. COMP. LAWS §§ 141.1541-.1575 (2012).

38. *Japan Report*, *supra* note 30, at 244-46 (describing the yellow card and red card systems).

detailed reporting and borrowing rules.[39] On paper, if an LPE fails to meet statutory benchmarks, it can be put into administration and its directors forced to pay damages.[40] In practice, however, the state often intervenes to guarantee LPE debts.[41]

In sum, these divergent governance approaches reflect a wide array of practical, legal, and political differences among the jurisdictions studied.

C. Divergent Procedures for Distressed LPE Treatment

As mentioned, most countries in our study lack a comprehensive framework for addressing LPE distress. Further, even in countries with a framework, such as the United States, there is room for improvement in establishing consistent, predictable procedures for the treatment of distressed LPEs.

Countries vary in terms of whether they address LPE distress via administrative oversight or through their insolvency laws. For example, Belgium,[42] Italy,[43] and the Russian Federation[44] all have well-established administrative oversight mechanisms for distressed LPEs, while the United States addresses LPE distress via an insolvency framework.[45] Thus, in some instances, LPE distress is resolved via the court system, and in others, it is resolved out of court. The source of the legal framework also varies significantly, with a variety of applicable rules drawn from different sources of law, including insolvency law, administrative law, and state and local government law, to name just a few. At times, such as in the case of Italy and Belgium,

39. *South Africa Report*, *supra* note 27, at 332 (describing the Local Government: Municipal Finance Management Act 56 of 2003, which "contains detailed rules on financial management, including reporting, by municipalities and all municipal entities").

40. *Id.* at 332-33.

41. *Id.* at 343 ("Between 1998 and 2017, there were 140 instances of interventions in 143 municipalities . . . .").

42. *Belgium Report*, *supra* note 28, at 103 (noting that a supervising authority "may exercise coercive supervision in the event of a manifest unwillingness or negligence on the part of a local administration to comply with its legal obligations, including budget rules").

43. Rolandino Guidotti, *Local Public Entities in Distress – A Critical Analysis of the Italian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 218, 225 [hereinafter *Italy Report*] (distinguishing the Italian financial distress procedure from a bankruptcy procedure or an arrangement with creditors).

44. Ilya Kokorin & Bilal Kurbanov, *Local Public Entities in Distress – A Critical Analysis of the Russian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 307, 313 (noting that the Russian Budget Code contains a special "interim financial administration" procedure "which can be applied with respect to a federal subject or a municipality with the purpose of restoring their financial stability").

45. 11 U.S.C. §§ 901-946.

the oversight of distress procedures involving LPEs is given to administrative rather than civil or commercial courts.[46]

D. Key Commonalities

In spite of the numerous differences that emerged from our study, we were able to pinpoint two key commonalities across different jurisdictions' treatment of distressed LPEs. First, a key theme underlying the varying approaches, at least on the books, was the notion of collectivity, or the idea that the process for addressing LPE distress should generally be procedurally collective and fair. Whether a collective proceeding occurred via insolvency law, administrative supervision, or elsewhere, the need to address LPE distress on a collective level was apparent in nearly all jurisdictions studied.

Second, continuity of essential public services and protection of vulnerable stakeholders were key to addressing LPE distress in all of the frameworks we studied, even if doing so meant occasionally deviating from established pari passu and egalitarian principles.[47] Some states even granted special protection to the principle of continuity of public services by explicitly including this protection within their laws. For example, Germany includes the principle of continuity of public services in its constitution.[48] Even if a state does not enshrine this protection literally within its laws or written procedures, it could be observed in practice.[49]

These two commonalities are remarkable given the extensive divergences discussed above. The fact that these commonalities exist despite the otherwise significant variance in the treatment of LPE distress illustrates their importance as bedrock principles that should undergird any proposal for the treatment of LPE distress going forward.

46. *Italy Report*, *supra* note 43, at 229 ("[T]he bodies involved in a financial distress procedure are essentially administrative."); *Belgium Report*, *supra* note 28, at 103 (discussing "the administrative supervision of local administrations").

47. On the distinction between equality and egality, see, for example, Eugenio Vaccari & Tara Van Ho, *Promoting Equity by Upholding Pre-Insolvency Entitlements: A Business and Human Rights Criticism to the Collective and Egalitarian Nature of Bankruptcy*, *in* RETHINKING INSOLVENCY LAW THEORIES (Emilie Ghio, Jennifer L.L. Gant & John Woods eds., forthcoming 2023) (on file with authors).

48. *Study Introduction*, *supra* note 7, at 21 (noting that Germany includes "not only the principle of continuity of public services, but also the more general principle of continuity of municipal entities" in its constitution).

49. *See, e.g.*, Gert-Jan Boon & Jelle Nijland, *Local Public Entities in Distress – A Critical Analysis of the Dutch Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 252, 264 ("A higher body is particularly likely to [intervene] when important public functions are at stake."); *Argentina Report*, *supra* note 3, at 45 ("In some provinces, there are laws that set limitations on judicial orders against municipalities, providing, for example, that measures may not affect the provision of essential services.").

III. PROPOSAL: TOWARD A MODEL LAW FOR DISTRESSED LPES

Drawing on specific examples from the national reports in our study, this Part proposes that a model law be developed for the treatment of distressed LPEs and discusses some of the principles underlying such a law. A model law is a suggested example for a law or framework, drafted by independent or international institutions, with the goal of being disseminated, adapted for enactment, and adopted in multiple independent jurisdictions across the world. A model law is appropriate because it allows for flexibility and variation among different jurisdictions while imposing a rule-based and principle-informed backdrop for jurisdictions to refer to and build upon.

A. Guiding Principles

As seen in the preceding Part, we observed two commonalities across the jurisdictions in our study: (1) the established principle of collectivity, and (2) continuity of essential public services. Building upon these commonalities, the key priority of a model law for distressed LPEs should be to ensure the continuity of essential public services without necessarily deviating from established insolvency principles of collectivity and equality of treatment among creditors.[50] To the extent deviations must be made, they should be done to protect vulnerable[51] or non-adjusting beneficiaries of LPEs' services.

50. *See, e.g.*, *Belgium Report*, *supra* note 28, at 103 ("The underlying rationale for excluding all public law entities from the scope of Belgian insolvency law is the principle of 'continuity of public services,' as a general principle of Belgian administrative law."); Catarina Ferraz, *Local Public Entities in Distress – A Critical Analysis of the Brazilian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 107, 112 ("[I]t is essential that specific provisions are set up to deal with illiquidity and public insolvency, not only to provide effective aid to restore the regular activities of subnational entities but also to avoid public managers using generic mechanisms and stretched interpretations to circumvent the law."); *Italy Report*, *supra* note 43, at 225 (describing Italy's treatment of distressed LPEs as "not merely limited to the payment of creditors, like other debtors, but involv[ing] guaranteeing the continuity of its services and functions"); *South Africa Report*, *supra* note 27, at 335 ("An important aim of the legislative framework dealing with municipal entities in distress . . . is to secure the continuation of public services despite the financial distress.").

51. On the concept of vulnerability, see, for example, Martha A. Fineman, *The Vulnerable Subject: Anchoring Equality in the Human Condition*, 20 YALE J.L. & FEMINISM 1 (2008); Martha A. Fineman, *Vulnerability and Inevitable Inequality*, 4 OSLO L. REV. 133 (2017); Martha A. Fineman, *Beyond Equality and Discrimination*, 73 SMU L. REV. F. 51 (2020). On attempts to implement vulnerability theories to insolvency scenarios, see, for example, Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 CAPITAL U. L. REV. 419 (1994); Chrystin Ondersma, *Overlooked Human Rights Concerns in the Restructuring and Insolvency Context*, *in* RESEARCH HANDBOOK ON CORPORATE RESTRUCTURING 466 (Paul J. Omar & Jennifer L.L. Gant eds., 2021); Jennifer L.L. Gant, *Optimising Fairness in Insolvency and Restructuring: A Spotlight on Vulnerable Stakeholders*, 31 INT'L. INSOLVENCY REV. 1 (2022); Jennifer L.L. Gant, *Reconsidering Fairness for Vulnerable and Involuntary Stakeholders in Insolvency and Restructuring*, *in* INSOLVENCY LAW: BACK TO THE FUTURE 55 (Eugenio Vaccari & Emilie Ghio eds., 2022).

Numerous jurisdictions provide examples of the primacy of continuity of public service. In Croatia, LPEs can use a special rehabilitation procedure overseen by higher-ranking public entities with the specific goal of ensuring continuity of public services.[52] In England, several laws are designed, directly or indirectly, to achieve continuity of public service.[53] For example, although the issuance of a section 114 notice under English law triggers a prohibition on an LPE incurring new expenses, there are exceptions for statutory services, including safeguarding vulnerable people.[54] In Australia, continuity of public service is a clear part of the local government system.[55] In Bangladesh, the scope of this principle is de facto extended to state-owned private companies delivering essential services to local communities.[56] In Belgium, the principle of continuity of public services is a general principle of the relevant administrative law.[57] In France, the essential services provided by public utility establishments fall back onto a local authority in the event the utility establishments are dissolved.[58] In Italy, case law recognizes that a guarantee of the functions and services provided by LPEs is one of the specific goals of the procedures applicable to LPEs.[59] South African law expressly states that an important aim of its framework is to secure the

52. Lidija Simunovic, *Local Public Entities in Distress – A Critical Analysis of the Croatian Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 137, 145-46 [hereinafter *Croatia Report*] ("[A] special rehabilitation procedure may be carried out on . . . public institutions established or owned by local public entities in order to preserve the continuity of the public service.").

53. *England Report*, *supra* note 3, at 169 ("There is, in other words, a preventive restructuring framework aimed at preventing local authorities from defaulting on their debts.").

54. *Id.* at 171 (noting that, once a section 114 notice is issued, "[a]ll but essential expenses are frozen").

55. *Australia Report*, *supra* note 3, at 68 ("[I]t is clear that continuity of public service is a part of providing a sustainable, flexible and effective system of local government that delivers to local communities.").

56. Morshed Mannan & Borhan Uddin Khan, *Local Public Entities in Distress – A Critical Analysis of the Bangladeshi Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 72, 83 ("Evidently, there is an intention to ensure the continuity of public services in practice, even if this intention is not explicitly stated in the legislation creating an entity.").

57. *Belgium Report*, *supra* note 28, at 103 ("The underlying rationale for excluding all public entities from the scope of Belgian insolvency law is the principle of 'continuity of public services' as a general principle of Belgian administrative law.").

58. Emilie Ghio, *Local Public Entities in Distress – A Critical Analysis of the French Approach*, *in* WHEN LIQUIDATION IS NOT AN OPTION: A GLOBAL STUDY ON THE TREATMENT OF LOCAL PUBLIC ENTITIES IN DISTRESS, *supra* note 1, at 181, 196 [hereinafter *France Report*] ("For administrative public services, if the establishment is dissolved, the service will fall back within the local authority as the principle of continuity of public service applies.").

59. *Italy Report*, *supra* note 43, at 226 ("The institutional bodies of a distressed entity guarantee the stabilization of a debtor's financial conditions by removing the structural causes that led to its distress.").

continuation of public services in spite of financial distress.[60] In addition, nearly all states in the study prevent distressed LPEs from being liquidated, in apparent attempts to ensure the continuation of the entity and the services it provides.[61]

Continuity of public services, however, is not the only commonality we observed. The insolvency-based principles of collectivity and equality of treatment of similarly situated creditors could also be observed, suggesting that continuity of public services should not be achieved at the expense of other procedural tenets of insolvency law. Indeed, uneven application of any framework taints the system with a perception of unfairness[62] and bias.[63] We therefore suggest that any deviations from insolvency's procedural tenets be institutionalized in a model law and that such deviations be designed to protect vulnerable and non-adjusting creditors. Indeed, substantive fairness requires that the interests of local taxpayers, as both contributors to LPEs and beneficiaries of their services, be prioritized over those of other claimants.

To determine what these deviations should look like, we need not start with a blank slate. Instead, we can draw upon best practices that we observed through our study. Hence, we recommend that a model law draw upon existing practices that achieve both substantive and procedural fairness.

Substantive fairness is concerned with a system's propensity to deviate from horizontal equity under the law "or when adjudicating disputes between parties with conflicting interests in an insolvency process."[64] To achieve substantive fairness, deviations from insolvency principles must take account of a broad range of different constituents.[65] In the restructuring context, specifically, this means that beneficiaries' contributions to a restructured entity are prioritized without unduly affecting the position of vulnerable claimants.[66]

60. *South Africa Report*, *supra* note 27, at 335 ("An important aim of the legislative framework dealing with municipal entities in distress . . . is to secure the continuation of public services despite the financial distress.").

61. *See, e.g.*, *U.S. Report*, *supra* note 31, at 367 ("As a general principle, LPEs cannot be liquidated."); *France Report*, *supra* note 58, at 194 (noting that laws applicable to LPEs "do not prescribe any insolvency procedure such as safeguard, rehabilitation or liquidation"); *Belgium Report*, *supra* note 28, at 102 ("Under Belgian law, local administrations cannot, in principle, be liquidated.").

62. On the notion of fairness and how it has been interpreted by courts, see, for example, Sarah Paterson, *Debt Restructuring and Notions of Fairness*, 80 MOD. L. REV. 600 (2017); Eugenio Vaccari, *Broken Companies or Broken System? Charting the English Insolvency Valuation Framework in Search for Fairness*, 35 J. INT'L BANKING L. & REGUL. 135 (2020); Eugenio Vaccari, *Promoting Fairness in English Insolvency Valuation Cases*, 29 INT'L INSOLVENCY REV. 285 (2020).

63. *See, e.g.*, *South Africa Report*, *supra* note 27, at 344-45 (discussing a "range of practical issues" surrounding interventions in municipalities, including the criticism "that interventions often have little to do with financial distress and much with political agendas").

64. *Study Introduction*, *supra* note 7, at 5.

65. *Id.*

66. *Id.* at 10.

Italian law illustrates how this aspect of substantive fairness works in practice. In Italy, a special code addresses distressed LPEs and adopts a modular approach to their treatment, such that different remedies are provided based on the severity of the entity's economic and financial situation.[67] To avoid arbitrary application, the entities involved in a distressed LPE's recovery have "clearly identified tasks, duties, and obligations" throughout the process.[68]

Other countries have adopted best practices upon which we can draw to achieve substantive fairness by ensuring the continuity of public services and the protection of vulnerable stakeholders. For example, as mentioned above, in Belgium, distressed entities that jointly propose a merger can receive a partial bailout from regional governments.[69] The portion of bailed-out debt is pre-determined by Belgian law and tied to the number of inhabitants of the merged entities.[70] Put differently, even though Belgian law provides that "debts must be paid as originally agreed," it also states that "deviations are possible under pre-identified conditions and standards," but "only for the purpose of ensuring the provision of essential public services to local communities."[71] In another example, Japanese law provides for state-guaranteed bonds for distressed LPEs.[72] The eligibility criteria is clearly laid out in the law for this type of support, and such precision serves to minimize political discretion.[73]

Not all of these approaches, by themselves, suffice to ensure substantive fairness. Nevertheless, they represent starting points to draw upon and ways to think about protecting substantive fairness in the context of LPE distress.

If substantive fairness is one guiding principle for the treatment of distressed LPEs, procedural fairness is another. "Procedural fairness is the propensity to rely on replicable and transparent procedures to deal with the interests of different parties in procedures involving" distressed LPEs.[74] Collectivity is a procedural principle, as it seeks to outlaw devices, such as individual enforcement of rights, that are designed to bypass the collective regime.[75]

67. *Italy Report*, *supra* note 43, at 224.
68. *Id.* at 226.
69. *Belgium Report*, *supra* note 28, at 100.
70. *Id.*
71. *Study Introduction*, *supra* note 7, at 16.
72. *Japan Report*, *supra* note 30, at 247.
73. *Id.* (discussing the process).
74. *Study Introduction*, *supra* note 7, at 5.
75. *Id.* at 6.

Belgium provides an example of the various ways in which laws might be drafted to ensure procedural fairness. Belgium has "strict budget rules" and substantial budgetary oversight, which helps prevent LPEs from becoming over-indebted.[76] Compliance with these rules requires significant accountability and procedural fairness.[77]

Although we can draw upon insights from the jurisdictions in our study, there is no one-size-fits all way to ensure substantive and procedural fairness in every jurisdiction because laws must account for existing legal systems and local conditions. Thus, our recommendation is that a model law provide options for a state to choose either an administrative or an insolvency approach as an overarching framework for dealing with distressed LPEs. Whichever approach a state adopts will depend on the existing approaches and legal background within the state. For example, if a state has an existing insolvency framework for corporate entities, it may make sense for the state to build from this framework and adapt it for LPEs. If, on the other hand, a state already primarily addresses LPE distress via administrative mechanisms, an administrative approach may be preferable. If a state lacks an insolvency framework altogether, such state might choose between either of these options depending on their legal traditions and cultures, as well as on the availability of experienced administrative or commercial courts for dealing with these issues.

One way of supporting substantive and procedural fairness is to facilitate and promote early detection of LPE distress, as well as early intervention to manage that distress. To do this, special consideration of the treatment of an LPE's management once the LPE begins to experience distress or insolvency is warranted.

Holding off on displacing management may encourage LPE leadership to seek help in times of early distress. In Italy, for example, unless local management has engaged in criminal or grossly negligent behavior, it is not displaced, even if special commissioners are appointed to assist.[78] Similarly, in South Africa, although the provincial authority will intervene to support a distressed LPE, displacement of management is not a typical first step.[79]

By contrast, in England, when financial difficulties are disclosed or uncovered, management is first supervised and then replaced by independent

76. *Belgium Report*, *supra* note 28, at 103.

77. *Id.* at 104 (describing an online tool whereby users can gain insight into Belgian LPEs' expenditures, revenues, financial balance, and debts).

78. *Study Introduction*, *supra* note 7, at 13.

79. *Id.*

commissioners that the government appoints.[80] Consequently, in England, management frequently has no incentive to disclose the existence of financial difficulties. Similarly, in parts of Australia, local officials have the power to dismiss all council civic offices once a public inquiry on the council's financial soundness has been held, and after the relevant minister recommends that such a step be taken.[81] Similarly still, in Croatia, LPEs in distress can use a special rehabilitation procedure overseen by higher-ranking public entities, resulting in the displacement of management for up to a two-year period.[82]

In short, although the exact system for addressing LPE distress will necessarily vary depending on existing structures and country preferences, all systems should be aimed at ensuring collectivity and continuity of public services through systems that strive for substantive and procedural fairness. While the jurisdictions we observed in our study fell short of fully achieving these outcomes, we can nevertheless identify best practices and present them as options for countries to consider as part of a model law.

B. Alignment with UNCITRAL Insolvency Principles

Given the similarities between the treatment of an LPE in distress and the treatment of a corporation in distress, it is logical to compare the principles undergirding the former with those undergirding the latter. To do this, we look to the insolvency principles stated in UNCITRAL's Legislative Guide on Insolvency Law.[83] This is because, even if a jurisdiction chooses to deal with LPE distress using administrative rules, these rules should still be grounded in insolvency law principles, as demonstrated by the commonalities discussed above. UNCITRAL believes that these principles should be reflected in every state's insolvency laws.[84] In articulating these principles, UNCITRAL attempted to balance the need to address a debtor's financial difficulty quickly and efficiently, the interests of various concerned parties, and public policy concerns.[85]

80. *England Report*, *supra* note 3, at 169 (noting that disclosure of financial distress "would lead to the disclosing local authority's existing management being supervised and eventually replaced by independent commissioners appointed by the Government").

81. *Australia Report*, *supra* note 3, at 61 (referencing the law in New South Wales).

82. *Croatia Report*, *supra* note 52, at 146.

83. U.N. COMM'N ON INT'L TRADE L., LEGISLATIVE GUIDE ON INSOLVENCY LAW, U.N. Sales No. E.05.V.10 (2005) [https://perma.cc/E6RQ-5P3S].

84. *Id.* pt. 1, at 10 ("Although country approaches vary, there is broad agreement that effective and efficient insolvency regimes should aim to achieve the key objectives identified below in a balanced manner.").

85. *See id.* at 10-14.

Generally speaking, the principles we advocate for with respect to distressed LPEs are similar to those advocated by UNCITRAL. For example, the same basic principles of collectivity and equality of treatment are present in the context of distressed LPEs as in UNCITRAL's general insolvency principles.[86]

Other areas in which our principles align with those of UNCITRAL include:

Promotion of economic stability and growth. Resolution of both corporate and LPE distress seeks to stabilize the entity in question and place it on a path of stability, if not growth.[87]

Equality of treatment of similarly situated creditors. This principle, known as pari passu, is present in both contexts, and UNCITRAL has also acknowledged that it may be modified by applicable "social policy."[88] As discussed above, deviations to protect vulnerable stakeholders are often enshrined in the laws and practices pertaining to LPE distress that we observed in our study.

Timely, efficient and impartial resolution. When dealing with a distressed entity, time and efficiency are of the essence.[89] This is true regardless of the type of entity—corporation, individual, LPE—that is distressed.

Recognition of existing creditor rights and establishment of clear priority rules. In both the specific context of LPE distress and more generally, it is important to have a recognized priority scheme so that treatment of creditors is not viewed as arbitrary or politically influenced.[90]

In its recommendations, UNCITRAL also notes that insolvency laws should "specify the role of the debtor in the continuing operation of the business during insolvency proceedings."[91] While declining to take a position on

86. *Id.* at 11 ("The objective of equitable treatment is based on the notion that, in collective proceedings, creditors with similar legal rights should be treated fairly.").

87. *Id.* at 10 (noting that "laws and institutions should promote restructuring of viable businesses . . . facilitate the provision of finance for start-up and reorganization of businesses and enable assessment of credit risk").

88. *Id.* at 11-12 ("Even though the principle of equitable treatment may be modified by social policy on priorities and give way to the prerogatives pertaining to holders of claims or interests that arise, for example, by operation of law, it retains its significance by ensuring that the priority accorded to the claims of a similar class affects all members of the class in the same manner.").

89. *Id.* at 12 ("Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business activities of the debtor and to minimizing the cost of the proceedings.").

90. *Id.* at 13 ("Recognition and enforcement in insolvency proceedings of the differing rights that creditors had with respect to the debtor and its assets before the commencement of insolvency proceedings will create certainty in the market and facilitate the provision of credit, in particular with respect to the rights and priorities of secured creditors.").

91. *Id.* pt. 2, at 173.

what that role should be, the recommendations lay out three approaches: (1) retention of full control (debtor-in-possession model); (2) limited displacement; and (3) total displacement.[92] UNCITRAL also recommends that insolvency laws should allow for management to be sanctioned if the debtor fails to comply with its insolvency law-related obligations.[93] Similar to UNCITRAL, we believe it is important for jurisdictions to specify the role of the debtor's management when an LPE becomes distressed or insolvent. Although sanctions may be needed in certain circumstances, we caution against immediate and total displacement of management out of concern that such action may discourage management from seeking assistance when it is needed.

Despite these similarities, some key differences exist between our principles and those of UNCITRAL, owing to the unique characteristics of LPEs. For example, UNCITRAL emphasizes maximization of asset value, an important concept in the corporate restructuring context.[94] However, in the context of distressed LPEs, an LPE's assets are not always available to creditors if they are needed to provide essential public services. Consequently, maximization of asset value—at least, in the case of some assets or classes of assets—may not be as important a principle in the distressed LPE context if those assets are not available to creditors.

The UNCITRAL principles also seek to strike a balance between liquidation and reorganization.[95] In the LPE context, however, the importance of continuity of the provision of essential public services means that liquidation cannot equate to the elimination of essential public services. Accordingly, although we see no reason to prohibit the liquidation of distressed LPEs outright, we argue that it is nevertheless critical that public services continue to be provided and in a manner that is accessible to the population served by the LPE.

Finally, UNCITRAL stresses that the estate must be preserved to allow equitable distribution to creditors.[96] In the distressed LPE context, although it is equally important that creditors not be able to dismantle an LPE via

92. *Id.*

93. *Id.*

94. *Id.* pt. 1, at 10 ("Participants in insolvency proceedings should have strong incentives to achieve maximum value for assets, as this will facilitate higher distributions to creditors as a whole and reduce the burden of insolvency.").

95. *Id.* at 11 ("An insolvency law needs to balance the advantages of near-term debt collection through liquidation . . . against preserving the value of the debtor's business through reorganization.").

96. *Id.* at 12 ("An insolvency law should preserve the estate and prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts.").

individual action, an LPE's assets must be preserved for use by the public as well as for the LPE's creditors.

Despite these differences, many of the same principles underlying UNCITRAL's general insolvency laws apply in the distressed LPE context. This lends further support to the idea that the treatment of LPEs in distress should largely align with the treatment of other distressed entities and that a model law for distressed LPEs is feasible.

C. Concerns and Challenges

Several obstacles stand in the way of the adoption of a model law for the treatment of distressed LPEs. Notably, defining an LPE may be difficult. As we have observed in our study, LPEs mean different things depending on country and context. Even when a definition can theoretically be agreed upon, nuances may arise in practice such that the definition may need to be adapted over time. For example, some entities, such as public-private partnerships and state-owned enterprises, may straddle the line between private company and LPE. In addition, local entities are often interdependent—on each other and on other entities, including some that are private. Although our study attempted to include as broad a range of entities as possible, states may or may not wish to adopt as broad a definition of *local public entity* as we have advocated.

Thus, significant work still needs to be done to define the scope and reach of any model law. Although, for purposes of this paper, we have referred to the definition of an LPE as used in our global study, that definition may need adjustment for purposes of a model law. It is preferable, however, that states across the globe adhere to a uniform, harmonized definition of LPE, as a harmonized framework applicable to different entities may fail to enhance predictability of outcomes and foster economic growth, including with respect to potential foreign investment in LPEs.

As seen in the illustrations discussed above, limiting political interference is a constant challenge with LPE distress. As governmental units, LPEs are inherently political in nature. Consequently, it may be difficult to untangle the treatment of distressed LPEs from the preferences, interests, or whims of politicians. Although the development of a model law could help provide some baseline consistency across countries, political interference that results in substantively or procedurally unfair outcomes is always a concern. No law, model or otherwise, will completely remove political interference. However, in seeking to strengthen accountability, what we accordingly seek to minimize is ad hoc, politically motivated interference that unduly favors some creditors or groups over others.

Finally, LPE distress, and the responses to it, are inherently not one-size-fits-all. For this reason, we suggest a modular and model approach, characterized by common guiding principles, rather than the creation of a uniform law addressing LPE distress. Further, in encouraging the development of a model law, although we rely on examples of specific practices from specific countries, we need not impose or develop specific practices for the treatment of LPE distress at an abstract level. Rather, states should be able to look to a model law for guidance on how to create their own implementation of a framework for distressed LPEs. Communicating key principles, as we have done in this article, helps communicate the end goals. As long as the end goals are the same—and the countries we have studied suggest that this is the case—the means of achieving those ends can be allowed to vary according to local fit.

CONCLUSION

Distressed LPEs are unique, and their situations undoubtedly differ from those experienced by distressed corporations. In addition, there are significant differences among jurisdictions that would make a uniform law impractical (and likely undesirable) to implement. However, as the discussion of our study and the UNCITRAL principles illuminate, despite their differences, jurisdictions tend to agree on some basic principles underlying the treatment of distressed LPEs. Furthermore, LPE insolvency is not so different from corporate or personal insolvency that a model law cannot be developed. The presence of shared underlying principles, coupled with their similarity to general insolvency law principles, lends hope that, by shedding light on these similarities and principles, the foundations for a model law can be laid.

Indeed, there is a critical need for many states to develop a workable and complete framework for dealing with distressed LPEs so that they can provide certainty and clarity to investors, creditors, and vulnerable stakeholders when LPE distress strikes. Although the exact contours of each state's framework will necessarily differ due to local needs and practices, the general principles supporting that framework should not differ and should be enshrined in a model law for the treatment of distressed LPEs.