

INSOLVENCY OF PUBLIC ENTITIES OTHER THAN THE STATE UNDER DUTCH LAW

Johannes A.F. Peters and Reinout D. Vriesendorp*

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1 Introduction

The question of whether a government can go bankrupt in the Netherlands is not a new one. The Supreme Court, for example, was asked as early as 1922 whether a municipality (in this case, Wormerveer) could be declared bankrupt.¹ Through the appeal in cassation, the court did not reach a principled verdict in this matter. Ever since, it has remained a vexed question that regularly kept rearing its head, both in the literature and in case-law. There were some striking cases in which bankruptcy proceedings were filed against a foreign state, such as the Republic of Zaire² and the Republic of Surinam.³ In both cases, immunity was assumed on account of the infringement of sovereignty of the state in question. But the question of the position of Dutch public entities - leaving the State of the Netherlands aside - is certainly still in order at the present time. Does a bankruptcy belong to the possibilities for a lower government that finds itself in serious financial problems? What could be done if the preliminary financing of the Victory Boogie Woogie (more than EUR 36 million!) by the municipality of The Hague had gone awry?⁴ What was the situation like when the Dutch province of Zuid-Holland incurred a financial setback running into millions in the Ceteco affair?⁵ What would happen if the municipality of Enschede were held liable for the many victims of the fireworks disaster in May 2000?⁶ What will be the consequences of the millions lost in the Dutch province of Gelderland as a result of actions by events organizer Gelderland Events?⁷

In this contribution, the issue is approached from two perspectives. First, the

* Johannes A.F. Peters is (university) lecturer of administrative law and Reinout D. Vriesendorp professor of civil and commercial law at the Faculty of Law, Center for Company Law, University of Tilburg, the Netherlands.

1. *Hoge Raad* [Supreme Court] 23 June, 1922, *W.* 10933, *NJ* 1922, p. 1030.
2. See Jacomijn J. van Hof, Barbara Reinhartz, and Lidwien Veraart, *De faillietverklaring van Zaïre* [The bankruptcy of Zaire], *NJB* 1988, pp. 636-637, and *Hof Den Haag* [The Hague Court of Appeal] 18 February 1988, *NJ* 1989, p. 602.
3. *Hoge Raad* [Supreme Court] 28 September, 1990, *NJ* 1991, p. 247.
4. This concerned the mid-1998 purchase of the famous Piet Mondriaan painting by *De Nederlandsche Bank NV* [The Dutch Central Bank] as a present to the Dutch people.
5. This was a type of risk investment, involving serious losses, of government funds by the province in the commercial trade corporation bank Ceteco N.V. which was declared bankrupt. As to possible bankruptcy consequences for the province of Zuid-Holland involved, see B. Wessels, *Kan een provincie failliet gaan?* [Can a province be declared bankrupt?], *NTBR* 1999/9, pp. 289-291.
6. On May 13, 2000, the SE Fireworks factory, in the centre of Enschede, exploded, killing 22 people and causing enormous damage in the city of Enschede. One of the causes seems to have been negligence on the part of the municipal authority.
7. Gelderland Events is a commercial company which, using government money supplied by the province of Gelderland, was going to 'put the province on the map', an adventure in which the province invested, and possibly lost, several million of euros (November 2001).

concept of 'government' is too vague and must be defined more closely (¶ 2). The second perspective concerns the aim, size, and working method in the case of bankruptcy (¶¶ 3-4). By eventually making the perspectives converge, we can shed some light on the question of whether a government can go bankrupt in the Netherlands and respond to the questions posed in the Questionnaire (¶ 5).

2 Governments in shapes and sizes

If there has ever been a clearly defined idea of what 'government' is, in the present-day social constellation, it is a vague concept. Not only new steering mechanisms like self-regulation and competition, but also social ordering and role patterns like privatization and liberalization have caused a large number of actors to become involved in public tasks. Since these tasks, which concern the public interest,⁸ are carried out by organization forms pertaining either to public or to private law, a clearly delimited definition of 'government' cannot be given, let alone, in one form or another, an organogram.

That does not mean to say, however, that no kind of ordering can be applied with respect to the executors of public tasks. Three distinctions can be made which can be relevant in the framework of the problems under discussion:

- a. public-law and private-law entities;
- b. implementation of tasks and exercise of powers;
- c. exclusively public activities or also performance of other commercial activities.

2.1 Public-law and private-law legal entities

The first distinction that can be made has to do with the legal form of an organization. Private-law legal entities have the legal forms regulated in Book 2 of the Dutch Civil Code (hereafter DCC), which means that their organization is regulated by the provisions set forth in Book 2 DCC. The legal forms in question are the *Naamloze Vennootschap* or *N.V.* [public company limited by shares], the *Besloten Vennootschap* or *B.V.* [private company with limited liability], the *Vereniging* [association], and the *Stichting* [foundation]. The organizational form of public-law legal entities are set out in special laws rather than in the Civil Code, although the latter does refer to them in Article 2:1. This placement has to do with the closed system of legal entities that the Civil Code was originally intended to be: it is only the legislator that can confer legal personality on organization forms.⁹ In this respect, Article 2:1, first paragraph, DCC, explicitly provides that: "The State, the provinces, the municipalities, the water control authorities, as well as all bodies on which, by virtue of the constitution, regulatory authority is conferred, possess legal personality." The second paragraph of this Article again emphasizes the closed system: "Other bodies to which part of a public task is assigned only possess legal personality if this follows from what has been laid down in the law."

8. Definition by C.A. Schreuder, *Publiekrechtelijke taken, private rechtspersonen* [Tasks pertaining to public law, legal entities pertaining to private law], Deventer: Kluwer 1994, p. 33.

9. See, for example, J.A.F. Peters, *Publiekrechtelijke rechtspersonen* [Legal entities pertaining to public law], Deventer: W.E.J. Tjeenk Willink 1997, pp. 15 ff.

Article 2:1 DCC confers legal personality on public-law organization forms. As regards the law on public organizations, the first paragraph regulates the legal personality (in addition to that of the State, which henceforward will be left out of consideration) of the official decentralized elements of our polity: the so-called public bodies. A 'public body' is a term pertaining to public law that refers to a 'community with members', which may include a regulatory authority, but in which in any case public-law powers play a role that can be influenced by the members.¹⁰ Some of the public bodies are explicitly mentioned in Art. 134 of the Dutch Constitution, which deals with the creation and discontinuation of public bodies. It is not always equally clear whether a government body should be considered a public body.¹¹ This is why this is often determined in a specific act. In addition, in pursuance of Article 2:1, first paragraph, DCC, any regulating authority a body may have must be taken into account. In practice, this means that, for qualification, a two-staged test applies. Some examples:

- The *Nederlands Instituut van register-accountants NIVRA* [Dutch institute of chartered accountants] is a public-law legal entity, because it is a public body in accordance with Article 1, second paragraph, Registered Accountants Act, *and* because, in pursuance of Article 19 of the same statute, the members' meeting possesses regulatory powers;
- The *Nederlandse Loodscorporatie* [Netherlands (Maritime) Pilots Organization] is a public-law legal entity because it is a public body on the basis of Article 6, first paragraph, Dutch Pilots Act, *and* because the members' meeting has regulatory powers pursuant to Article 15 of the same statute;
- The *Nederlandse Orde van Advocaten* [Dutch Bar Association] possesses legal personality because it is a public body on the basis of Article 17 of the Counsel Act, *and* because the council of representatives possesses regulatory powers in accordance with Article 28 of the same statute;
- The *Koninklijke notariële beroepsorganisatie* [Royal Netherlands association of civil law notaries] possesses legal personality because it is a public body on the basis of Article 56 of the Notaries Act, *and* because the general meeting possesses regulatory powers in accordance with Article 65 of the same statute.

2.2 Implementation of tasks and exercise of powers

The second paragraph of Article 1, Book 2 DCC provides the possibility to confer legal personality on other organization forms. What we are dealing with in this case

10. Compare H.D. van Wijk/Willem Konijnenbelt/Ron. M. van Male, *Hoofdstukken van bestuursrecht* [Topics of administrative law], The Hague, Elsevier 1999, p. 122, C.P.J. Goorden, *Rechtsbevoegdheid in het bestuursrecht* [Legal authority in administrative law], Zwolle: W.E.J. Tjeenk Willink 1990, p. 27, as well as P. de Haan/Th.G. Drupsteen/R. Fernhout, *Bestuursrecht in de sociale rechtstaat. Deel 1. Ontwikkeling, Organisatie, Instrumentarium* [Administrative law in the social, law-governed state. Part 1. Development, Organization, Instruments], Deventer: Kluwer 2000, p. 184.

11. See the example of the *Sociaal Economische Raad* [Social Economic Council] in J.A.F. Peters, *o.c.*, p. 90.

is a motley collection of divergent governmental organizations. A random selection:

- *Bedrijfsfonds voor de pers* [Press fund]: Article 123, first paragraph, Media Act;
- *Centraal Fonds voor de Volkhuysvesting* [Social Housing Guarantee Fund]: Article 71, first paragraph, Housing Act;
- *Centraal Orgaan opvang Asielzoekers* [Central body for the reception of asylum seekers]: Article 2, first paragraph, Central Organ for the Reception of Asylum Seekers Act;
- *College van Toezicht Sociale Verzekeringen* [Social Security Supervisory Board]: Article 2, second paragraph, Social Security Organization Act;
- *Commissariaat voor de Media* [Public Broadcasting Commission]: Article 9, first paragraph, Media Act;
- *Dienst voor het kadaster en de openbare registers* [Land and Public Registry Agency]: Article 2, first paragraph, Land Registry Organization Act;
- *Rijksdienst voor het Wegverkeer* [Department of Road Transport]: Article 4a, Road Traffic Act;
- *Instituut voor Toetsontwikkeling* [National Institute for Educational Measurement]: Article 38, first paragraph, Educational Support Structures Act;
- *Koninklijke Bibliotheek* [National Library of the Netherlands]: Article 1.16 Higher Education and Research Act;
- *Koninklijke Nederlandse Akademie van Wetenschappen* [Royal Dutch Academy of Arts and Sciences]: Article 1.16 Higher Education and Research Act;
- *Landelijke selectie- en opleidingsinstituut politie* [National Police Selection and Training Institute] Article 2, second paragraph, National Police Selection and Training Institute Act;
- *Luchtverkeersbeveiligingsorganisatie* [Air Traffic Control]: Article 22 Air Traffic Act;
- *Nederlands instituut voor brandweer en rampenbestrijding* [Netherlands Institute for Fire Service and Disaster Management]: Article 18a, first paragraph, Fire Services Act 1985;
- *Nederlandse Organisatie voor toegepast-wetenschappelijk onderzoek TNO* [Dutch Organization for Applied Scientific Research]: Article 3, second paragraph, TNO Act;
- *Politieregio* [Police region]: Article 21, fourth paragraph, Police Act of 1993;
- *Schadefonds geweldsmisdrijven* [Criminal Injuries Compensation Fund]: Article 2, second paragraph, Criminal Injuries Compensation Fund Act;
- *Sociale verzekeringsbank* [Social Security Bank]: Article 21, second paragraph, Social Security Organization Act.

In government activities, tasks and powers can be distinguished, although these two are obviously connected. By 'powers' we mean the typically public authority, i.e., the public-law power to unilaterally determine the legal relations with another person (a citizen).¹² The legality principle - one of the fundamental principles of our democratic state under the rule of law - entails that such authority must be based on

12. Compare Van Wijk/Konijnenbelt/Van Male, *o.c.*, p. 202.

the law. Not only is that authority defined, it is also indicated to which administrative body the authority is assigned. The fact that a public-law power is assigned implies that the task in question belongs to the government. If the government had no task to carry out, no assignment of authority would be necessary. However, this line of reasoning cannot be reversed: a task does not imply a public-law power.¹³

What must be seen as a public task depends on politico-ideological views.¹⁴ In general, it may be pointed out that tasks are mostly covered by related public-law rules. Cases in point are the provision of drinking water and energy. No matter how 'private' the purveyors may be - the shares are mostly in government hands - the fact that rules are laid down makes it quite clear that we are dealing with an activity that the government considers to be among its tasks.

In the light of the preceding distinction between public-law and private-law legal entities, it can be established that, in both legal forms, it is possible not only to carry out public tasks but also to exercise public-law powers. It should be noted that - in view of their public-law background - public-law legal entities always deal with public tasks, without this necessarily having to imply public authority. A combined example of both organization form and power to carry out a task is education. Undoubtedly, this is a task the government has set itself and which involves both public-law legal entities - for example, public universities such as Utrecht University or Leyden University (Article 1.8, second paragraph, Higher Education and Scientific Research Act) - and private-law legal entities - for example, the *Stichting Katholieke Universiteit Brabant* [Tilburg University Foundation]. Both possess public-law powers such as the issuing of legally recognized diplomas.

With respect to public-law powers, a final remark must be made concerning decentralization. In view of their place in the polity, public bodies possess the autonomy to regulate their own households. This means that, to a certain extent, they can use their own discretion when acting as regulators and administrators, obviously within the restrictive parameters set at the decentralized level, whether territorially or functionally.¹⁵ In the framework of this contribution, it is important to note that in this respect these public bodies have an 'open' authority to regulate a variety of subjects with 'matching' powers.

13. This is a point of criticism of the so-called 'public-task case law' in which the administrative judge applies public-law norms to private-law executors of public tasks.

14. See, for example, H.J. de Ru, *Staat, markt en recht* [State, market, and law], Zwolle: W.E.J. Tjeenk Willink 1987.

15. See, for example, M.C. Buskens/H.R.B.M. Kummeling/B.P. Vermeulen/R.J.G.M. Widdershoven, *Beginselen van de democratische rechtsstaat* [Principles of the democratic state under the rule of law], Deventer: W.E.J. Tjeenk Willink 2001, pp. 284 ff.

2.3 *Exclusively public activities and/or performance of other commercial activities*

Privatization and liberalization have led to shifting boundaries between the government sector and the private domain. One of the consequences of this is that public tasks are also implemented by private-law organization forms. But the reverse is also true: as a result of liberalization, activities engaged in by government bodies have turned into market activities. An example: through the creation of a market with several players, the activities of the - originally monopolist - *Koninklijk Nederlands Meteorologisch Instituut* [Royal Dutch Meteorological Institute] have become market activities. As long as the activities of an organization are unequivocal - either exclusively governmental or exclusively market-oriented -, the boundary between 'government' and 'market' is shifting but can still be drawn with respect to the organizations themselves. A problem, however, is that in practice it does not work that way. Private enterprises have taken over government activities, but combine them with clear market activities. On the other hand, government organizations are entering into the market in competition with third parties. In this way, revenues are generated in a time when government policy is one of retrenchment. But policy-makers have also consciously aimed in the same direction because a 'competing government' is said to work more cost-effectively and to be more client-oriented. An example is the *Landelijk selectie- en opleidingsinstituut politie* [National Police Selection and Training Institute], which also provides courses and trainings for private companies.¹⁶ The consequences of these developments are twofold: competition arises between the government and the private sector, and the government becomes ever more 'infected' by market activities. On the one hand, this can lead to unfair competition, and on the other hand, there is the risk of government money being employed for the 'sidelines'. To keep these consequences under control, legislative action is now being undertaken. The Framework Act on Autonomous Administrative Authorities¹⁷ contains a provision that the various activities engaged in by private-law legal entities must be administered and accounted for separately. In view of the shifting boundary, the question arises why this is not prescribed in this act with regard to public-law legal entities also.¹⁸ It may be related to a highly controversial bill "Regulations concerning market activities of governmental organizations and concerning companies which have a special position as prescribed by the government", or Market and Government Act, for short.¹⁹ In this act, the rules of entry and the rules of conduct are stipulated for governmental organizations and state companies together with companies with special rights. As a result, it is a bill that is strongly inspired by competition law.

As regards this problem, these legislative projects show an interesting

16. This example is taken from *Kamerstukken* [Parliamentary documents] II, 2001/02, 28 050, no. 3, p. 13.

17. *Kamerstukken*[Parliamentary documents] II, 2000/01, 27 426, nos. 1-3.

18. See J.A.F. Peters, The Framework Act Independent Administrative Bodies: A First Introduction, *Tijdschrift Privatisering* 2000/5.

19. *Kamerstukken II* 2001/02, 28 050, Nos. 1-2.

distinction between a ‘public part’ in the accounts and a ‘private part’. Yet, the question should be raised how clear this distinction will be in practice. Furthermore, they are still separate parts in the accounts of one and the same property. Holding on to this distinction in the framework of a bankruptcy - the public part would remain unaffected by the bankruptcy - would mean a violation of the principles of property law and insolvency law.

3 Government activities and the risk of bankruptcy

Irrespective of the legal form (public and/or private legal entities), a government body with duties and competence pertaining to public law can get into financial difficulties. In this respect, it is important that, in principle, every debtor is obliged, to the full extent of his assets, to pay his own debts (Article 3:276 DCC); no exceptions are made for governments. However, it should be borne in mind that ‘a debtor’ is meant to be a separate legal entity, with its own rights and obligations. Public bodies or other entities without its/their own legal personality, which belong to a certain (wider) legal entity, have the same rights and obligations. This means that if an independent (public-law or private-law) legal entity with governmental duties can be identified as such, its creditors will have recourse to its assets.

3.1 Tackling financial difficulties

If a government entity gets into financial difficulties, with expenses exceeding revenues, there are roughly two possibilities to respond: an attempt can be made either to increase revenues and/or to decrease expenses. If this is successful, a situation of bankruptcy is avoided and bankruptcy law does not play a role. Therefore, we will not take this situation into account below. What happens, however, if neither of the two possibilities occur?

A special situation in this respect concerns the municipality as a legal entity governed by public law. Every Dutch municipality annually receives a payment from the national *Gemeentefonds* [Municipalities Fund]. This fund is for the most important part funded by a percentage of the State’s tax revenues, which is determined annually. The payment a municipality receives from the State is determined according to objective standards. In administrative practice, it has turned out that, even if there is a balanced system of distributive standards, this does not automatically mean it meets the individual requirements of municipalities. Therefore, in the *Financiële-Verhoudingswet* [Financial Relations Act], a subjective way to balance the books has been included in Article 12. If the general financial means of a municipality has been exceeded considerably and structurally, the municipality can apply for a supplementary payment on the grounds of Article 12 of the Financial Relations Act. Such a supplementary payment is mostly subject to various regulations (such as increase of own income and restriction of expenses), so that a municipality will to a certain extent be administered by the Ministry of the Interior.

3.2 Concursum creditorum

If the attempt to steer a different financial course comes too late or fails, a new situation arises. If the legal entity's assets are insufficient to pay all its creditors and *concursum creditorum* occurs (i.e., there are competing creditors), additional measures have to be taken. In this context, however, it should be noted that insolvency - the fact that a debtor's liabilities exceed its assets - in itself does not decide the question of whether or not a bankruptcy must be declared. What counts in the Netherlands is a liquidity test: if a debtor can no longer meet its current, due debts, the court may declare it - either at the request of a creditor or at its own request²⁰ - to be in a state of bankruptcy. This criterion is based on Arts. 1 and 6 Bankruptcy Act, which refer to the debtor who is in a state of having ceased to pay its debts. This is a situation of insolvency within the substantive meaning of the law. Although this implies an investigation by an impartial judge, in practice, it is a limited examination, with the judge restricting himself to briefly checking whether the substantive requirements for declaring a bankruptcy have been met.

3.3 *The purpose of the bankruptcy*

The aim of the bankruptcy is to arrive at an orderly winding-up of the *concursum creditorum* with regard to the insufficient estate. To this end, the court appoints an independent *curator* (bankruptcy trustee, usually a specialized lawyer), who, under the supervision of a *rechter-commissaris* (bankruptcy judge) also appointed by the court, takes care of the administration and winding-up of the bankrupt estate. The starting-point in the division is equality of the creditors (*pari passu-principle*), in the sense that, in principle, every creditor must be paid in proportion to his claim. In practice, however, such - competing - creditors will rarely receive any payment on their claim. If anything is left at all after the secured creditors (financiers with rights of pledge and mortgage; purveyors with title retention) have been paid, then, after deduction of all the bankruptcy costs, the preferential creditors, such as the internal revenue, social premiums, and staff pensions and salaries, are paid first and any leftovers are paid to the unsecured creditors.

The above applies to all debtors. Although one may in the first place think of private entities that, on the basis of legal rules, are declared to be in a state of bankruptcy, we note that the law does not make an exception for public legal entities. This means that a court must apply the same criteria when it happens to be confronted with a bankruptcy petition concerning a public legal entity as a defaulting debtor. If this entity is in a situation in which it has ceased to pay its debts, the court has to declare it bankrupt.

4 **Consequences of the bankruptcy**

If a legal entity is declared to be in a state of bankruptcy, a bankruptcy trustee - under the supervision of a bankruptcy judge - will deal with the administration and winding-up of the bankrupt estate. The question arises how this intervention relates to the public character of the bankrupt legal entity. It is unclear, for example, to what

20. Pursuant to Art. 1 Bankruptcy Act, it is among the Public Prosecutor's options to provoke a bankruptcy order for reasons of public interest, but in practice this hardly occurs.

extent the bankruptcy trustee can deal with administrative disputes that might have financial consequences for the estate (for example, subsidy disputes); whether he can hold bodies and persons liable by analogy with the provisions of Art. 2:138/248 DCC with respect to improper management; and whether he can take criminal action or institute legal proceedings against 'higher' or otherwise supervisory bodies (ultimately, the state, the Kingdom of the Netherlands). Let us take a closer look at the influence on the powers and tasks that have been assigned to public legal entities.

4.1 Powers assigned to public entities and bankruptcy

Traditionally, the concept of 'subject' has been considered differently between private law and administrative law. In private law, it is the legal entity that counts; in administrative law, it is the administrative body, as the entity carrying the authority. The distinction is evident in the central government and in decentralized governments: the legal entities are the State, the province, the municipality, and the water control authority; the administrative bodies are persons or boards that function within these and have been assigned powers, such as a minister, the Queen's commissioner, the Provincial Council, the mayor, the municipal council, and the chairman of a water control council. The distinction is smaller, however, than is generally assumed. Also in typically public-law situations, powers are assigned to public-law legal entities. In mass-media legislation, for example, powers are assigned to the Public Broadcasting Commission, which is a legal entity governed by public law. And in the case of legal entities governed by private law, the powers are directly assigned to the legal entity.²¹

What all the variants have in common is that a public-law competence cannot be seen as an asset or property right that, in the event of a bankruptcy, will be exercised by the bankruptcy trustee. But the exercise of the public-law competence *is*, of course, influenced by the operation of the bankruptcy, if only because, for the exercise of powers, financial means are necessary which fall under the bankruptcy. This raises the question to what extent the exercise of public-law powers is still opportune. If the administrative process is halted because of the lack of sufficient funds, this can be most damaging and undesirable. Consequently, it might be a reason for withdrawing the public-law power and for subsequently assigning it to another administrative body, so that the administrative process can effectively continue. Just as the assignment of public-law powers should be based on the law, so its withdrawal should have a statutory basis. A case in point is the *Organisatiewet Sociale Verzekeringen* [Social Security Organization Act] 1997. On the basis of Art. 38 of this act, the national institute for social security has been assigned the task to implement various social security laws, a task which entails public-law powers. On the basis of Art. 39, that power can be handed over to an implementation agency. This implementation agency, however, must be recognized by the minister (Art. 59), a recognition that, in accordance with Art. 61 of the Social Security Organization Act 1997, is withdrawn as soon as the implementation agency is declared to be in a state of bankruptcy.

21. See J.A.F. Peters, *Rechtspersonen als bestuursvormen voor openbaar onderwijs* [Legal entities as administrative forms in public education], *School en wet* [School and law] 2000, no. 1.

A special situation exists with respect to the internal organization of public bodies as decentralized building blocks of the Dutch polity, the provinces and municipalities. It would have incalculable and insurmountable consequences if a province or a municipality were to be unable to perform its administrative duties. At issue in such a case is not a single specific administrative power that, after withdrawal, could be assigned to some other body, but the functioning of an entire administrative layer of public administration. What is then at stake are crucial social values like public order and safety, hygiene and health care. The same goes for public-law legal entities with such special primary national tasks as a police district. The underlying social complexity constitutes an obstacle to a bankruptcy of the legal entity. For such differentiation, however there is little room in bankruptcy law. This means that a solution must be found in public law. It is conceivable that a legal provision excludes the application of bankruptcy law, but preventing a bankruptcy situation is to be preferred, since this provides a better safeguard for the performance of public duties. One may think of public-law safety nets, of which the above and often-mentioned Art. 12 of the Financial Relations Act constitutes a good example.

4.2 *Public tasks and the operation of the bankruptcy*

As far as a legal entity is engaged in the implementation of commercial tasks, the bankruptcy trustee can wind up the bankrupt estate as if the legal entity managed an 'ordinary' commercial enterprise: there is no room for special treatment. If, however, typically public tasks like schooling, and primary provisions like water, energy, and waste disposal are concerned, it is of great importance that these continue to be carried out as much as possible without hindrance. As a first option, many of these public tasks can be taken over by others. If one waste disposal company is declared bankrupt, we can hire another, irrespective of its status as a private-law legal entity or a public-law legal entity. But this is not always possible. The execution of some public tasks can depend on technological conditions that do not obtain elsewhere. An example is the production of drinking water (a network with pumps and purification installations). Again, the legal exclusion of bankruptcy rules could be an option here. In the US, for example, this took place with respect to the railways. Another option for the bankruptcy trustee is to include an obligation to continue to deliver. A case in point is the supply of drinking water: the Water Supply Act contains an order to the proprietor of the water supply company to deliver (Art. 4, Water Supply Act). Needless to say, such an obligation to deliver becomes illusory when the bankruptcy trustee simply lacks the necessary means. In such cases, therefore, supplementary means will have to be made available.

4.3 *Public interests and a bankruptcy*

A bankruptcy that does not take the continuity of public tasks into account can lead to unacceptable erosion of the execution of public tasks, and must therefore be rejected. This is because the effects of a bankruptcy can run counter to the public interests involved in a government activity. The bankruptcy of a police district, therefore, is hardly conceivable, but that of, for example, *TNO* [the Dutch Organization for Applied Scientific Research] is possible. The question arises

whether the bankruptcy rules can offer a solution to dilemmas of this kind. If this is not the case, the obvious choice is to start from the government activity and, on that basis, to stipulate in special legislation that bankruptcy is not an option. In the light of the above, however, this will not suffice. Given both the distinction and the relation between tasks and powers, such special legislation should provide for a number of issues. If the administration in question is complex, as in the case of the decentralized public bodies or crucial social tasks, the preference should be for the bankruptcy situation to be prevented by providing public-law mechanisms. In the case of simple public-law powers, a bankruptcy might constitute grounds for withdrawal of the power. If execution of public tasks but no public-law powers are concerned, there is similar differentiation. For some public tasks, it is possible to replace the responsible body if it gets into financial problems. It is also conceivable that the execution of the public task is deferred without this leading to social problems. However, there are also government tasks that are so specialized or linked to other (physical) conditions that replacement is not an option. In the cases that continuation of the tasks is socially indispensable, the duty to execute the tasks can be specified in legislation, but with an eye to continuity - as in the case of public-law powers - a public-law financial safety net to prevent bankruptcy is the preferred option.

It may be hard to conceive bankruptcies of government bodies, but given the current social developments, in which the once clear distinction between the government and market sectors are gradually mixed and the two sectors increasingly operate on an equal level, it may be better to appreciate the existence of this phenomenon. In this context, we refer to the examples mentioned in the introduction.

5 The Questionnaire and concluding remarks

For the XVth Congress of the Academy of Comparative Law, a Questionnaire was used with a definition and 12 questions for the national reports about the "Insolvency of Public Entities Other than the State". In this last section, we want to recapitulate these questions and answer them briefly. Some questions were discussed only implicitly above and will here be explained in more detail.

The Questionnaire uses a rather specific definition of public entity: AA public entity in this context means an entity created by the State as a public law body with separated budgets and accounts and some degree of autonomy. We have adopted a broader perspective as far as the organization forms covered in this report are concerned. This has to do with the Dutch situation, but also (the sting is in the tail) because question 11 is about the positioning of other legal entities. These were already included in the above. Our responses to the questions in the Questionnaire are as follows.

1. What are the sources of the financial means at the disposal of the entities?

As discussed above, the concept of 'public entity' is a set of very different organizations with different legal forms. The financial sources are equally varied: public taxes (in particular public bodies), subsidies (although the flow of money between government authorities is not referred to as such), and/or income from

commercial activities (mainly the ‘mixed entity’, which carries out both public tasks and market activities). Furthermore, public bodies can make use of private funding, such as loans and bank credit.

2. What are the rules of procedure (internal and external) applicable to the use of private law sources of finances (validity of the private law contracts)?

This issue was not explicitly dealt with above. In the Netherlands, no distinction is made between ‘public-law money’ and ‘private-law money’, which latter category is generated by commercial activities. Therefore, this question in fact concerns the representation of the legal entity and the procedure that precedes it. A distinction must be made between the internal and external procedures relevant to representation. The internal procedure is the way in which the ‘will’ of the legal entity is formed; the external procedure concerns the question of who is competent to act on behalf of the legal entities and the way in which this is done. Furthermore, a distinction must be made between legal entities governed by public law and those governed by private law. As to both, statutory rules determine who can act on behalf of the legal entity. Book 2 DCC provides rules on representation (usually (one or more member of) the board) for legal entities governed by private law and, as regards legal entities governed by public law, the rules apply which define the relevant public entities. Below is a selection of these provisions:

5.1 Public bodies

- Province: Art. 176 Provinces Act, by the Queen’s Commissioner (*commissaris van de Koningin*)
- Municipality: Art. 171 Municipalities Act, by the mayor (*burgemeester*)
- *Nederlands Instituut van register-accountants NIVRA* [Dutch institute of chartered accountants]: Art. 21 Registered Accountants Act, by the general director (*voorzitter*)
- *Nederlandse loodsencorporatie* [Netherlands (Maritime) Pilots Organization]: Art. 7 Dutch Pilots Act, by the president
- the *Nederlandse Orde van Advocaten* [Dutch Bar Association]: Article 31 of the Counsel Act, by the general council
- *Koninklijke notariële beroepsorganisatie* [Royal Netherlands association of civil law notaries]: Art. 62 Notaries Act, by the board or by the (deputy) president together with another member of the board.

5.2 Other public entities

- Bedrijfsfonds voor de pers [Press Fund]: depending on its own rules, pursuant to Art. 125, second paragraph, Media Act
- *Centraal Fonds voor de Volkshuisvesting* [Social Housing Guarantee Fund]: depending on rules set out in a decree on the basis of to Art. 71, second paragraph, Housing Act
- *Centraal Orgaan opvang asielzoekers* [Central body for the reception of asylum seekers]: Art. 11 Central Reception Organization for Asylum Seekers Act, by the (deputy) president and another member of the board

INSOLVENCY OF PUBLIC ENTITIES OTHER THAN THE STATE

- *College van toezicht sociale verzekeringen* [Social Security Supervisory Board]: depending on the regulations pursuant to Art. 8 Social Security Organization Act
- *Commissariaat voor de Media* [Public Broadcasting Commission]: depending on own rules pursuant to Art. 11, third paragraph, Media Act
- *Dienst voor het kadaster en de openbare registers* [Land and Public Registry Agency]: Art. 8, first paragraph, Land Registry Organization Act, by the board or any board member
- *Rijksdienst voor het Wegverkeer (RDW)* [Department of Road Transport]: Art. 4g, first paragraph, Road Traffic Act 1994, by the management
- *Informatie Beheer Groep* [Information Management Group]: Art. 7, fourth paragraph, Privatisation of the Information Bank Act, by members of the central management
- *Instituut voor Toetsontwikkeling* [National Institute for Educational Measurement]: Art. 49, third paragraph, Educational Support Structures Act, jointly by the (vice-)chairperson and the secretary or a replacement appointed by the board of governors
- *Koninklijke Bibliotheek* [National Library of the Netherlands]: Art. 13.3, sixth paragraph, Higher Education and Research Act, by the president of the board of governors
- *Koninklijke Nederlandse Akademie van Wetenschappen* [Royal Netherlands Academy of Arts and Sciences]: Art. 13.1, sixth paragraph, Higher Education and Research Act, by the president of the board of governors
- *Landelijk selectie- en opleidingsinstituut politie* [National Police Selection and Training Institute]: Art. 5, fifth paragraph, National Police Selection and Training Institute Act, by the director and another board member appointed by the board of governors jointly
- *Luchtverkeersbeveiligingsorganisatie* [Air Traffic Control]: Art. 27, first paragraph, Air Traffic Act, by the board
- *Nederlands instituut voor brandweer en rampenbestrijding* [Netherlands Institute for Fire Service and Disaster Management]: depending on the regulations pursuant to Art. 18c, third paragraph, Fire Services Act 1985
- *Nederlandse Organisatie voor toegepast-natuurwetenschappelijk onderzoek TNO* [Dutch Organization for Applied Scientific Research]: Art. 9, first paragraph, TNO Act, by the chairman and another member of the board of management
- *Police region*: Art. 22, third paragraph, Police Act 1993, by the regional police force manager
- *Schadefonds geweldsmisdrijven* [Criminal Injuries Compensation Fund]: Art. 2, second paragraph, Criminal Injuries Compensation Fund Act, by the deputy chairperson
- *Sociale verzekeringsbank* [Social Security Bank]: depending on the regulations pursuant to Art. 26 Social Security Organization Act.

In the internal procedure, it is determined how far the authority of the representative shall reach. Limitations can be set on the basis of both Book 2 DCC and public law regulations or an internal decision will have to be made before the representative can

act legally. The question arises whether a fault in this internal procedure or a limitation imposed has any legal effect towards third parties. On this point, there seems to be a difference between legal entities governed by private law and entities governed by public law. In the first category, the legal person can base its objections in the event of unlawful representation only on limitations pursuant to the applicable law. This issue is more complicated with public entities, as can be demonstrated with the following four categories of cases in which something goes ‘wrong’.

- a. A decision of a particular body necessary for representation of the legal entity is absent or the representative exceeds the limits of this decision.
- b. There is a preliminary decision, which, however, requires the approval of another government body pursuant to the law (Apreventive supervision)
- c. A preliminary decision is annulled on the basis of a different government body’s right of total annulment (Arepressive supervision; see Art. 268 Municipalities Act, Art. 261 Provinces Act, Art. 156 Water Authorities Act);
- d. A necessary budget item is missing (see Arts. 189, fourth paragraph, and 208 Municipalities Act, Arts. 193, fourth paragraph, and 212, first paragraph, Provinces Act).

The principal point of discussion here is whether the public-law organization in itself must be considered or whether this case must be considered as a general private-law matter of representation and authority.²² Case law concerning the various cases differs. On the absence of a budget item (d), the courts do agree: it does not have external effect. Repressive supervision (c) will not lead to problems either, since the legislator has explicitly stated that a legal act under private law is affected in the sense that it is not further implemented from the moment of the annulment decision. The bottleneck is therefore in preventive supervision (b) and the decision leading to it (a). It seems to have been the legislator’s intention that no external effect will ensue. This is sometimes implicitly mentioned, for example, in the explanatory memorandum to the Government Accounts Act on the relationship between the legal entity governed by public law and the act of representation governed by private law: AThe above leads to the conclusion that all provisions [...] necessary to obtain permission, notification, the availability of budget resources, etc. must be considered as guarantees for a sound and responsible functioning of the government, but must not serve as requirements for the validity of the acts under private law.²³ However, this ‘only’ represents the idea of the legislator; the courts might have a different opinion. It does not necessarily end the discussion of this principal issue. It may be argued that lack of competence does have external effect.²⁴

22. See W.H. van Boom, *Overeenkomsten met overheidslichamen* [Contracts with Public Bodies], in: C.J.H. Brunner/E.H. Hondius (red.), *Verbindenissenrecht*, Deventer: Kluwer (losbl.), pp. II-157 ff.

23. *Kamerstukken II 1973/74*, 13 037, no. 3, p. 31. This thought is also expressed in Articles 31, 44, 50c, 55, 64, 77, and 87 Community Regulations Act, see *Kamerstukken II 1980/81*, 16 538, no. 3, p. 44.

24. Cf. Van Boom, *op.cit.*, p. II-176 ff and J.C.E. Ackermans-Wijn, *Vertegenwoordiging van de overheid bij privaatrechtelijke rechtshandelingen* [Representation of Government Agencies through

3. *What guarantees do private creditors require if any?*

In this context, there is no difference between public entities governed by private law and those governed by public law. If creditors want (more) security that their claims will be satisfied, they can negotiate security on a contractual basis, such as surety, a right of pledge or mortgage, or a guarantee.

4. *Is there an a-priori limit to the level of debt(s) an entity may incur (maximum level authorized by the State; mere reference to the principles of good administration)*

There is no rule allowing a legal entity to incur debts to a particular maximum amount. Art. 2:108a DCC specifies, however, that if the equity capital of a company limited by shares falls below half the amount of the paid-up capital of the share capital, a shareholders meeting must be convened. The level of the debts incurred, however, is directly linked to the financial policy that has been pursued. In a private-law entity, the issue may arise in the framework of approval of management (discharge). In a public-law context, it depends on the applicable law. In a decentralized state structure, repressive supervision may play a role here as regards public entities (see question 2): a decision to incur a large debt may be reversed on the basis of its being incompatible with public policy if the law (for instance, the Province or Municipalities Acts) so provides. It must be observed that this reversal 'only' holds for the future and that the right to total annulment is used very sparingly.²⁵ Of course, it is also possible that a right of approval has been laid down in a special legal provision (preventive supervision). This instrument, too, is used sparingly to prevent the government from becoming an unreliable partner.

5. *What are the safeguards to ensure that an entity does not become insolvent (internal audit; external audit; control by a State authority such as a comptroller)?*

Every legal entity has the duty to render an account of the policy pursued. This holds for entities governed by private law pursuant to the applicable provisions in Book 2 DCC and those governed by public law on the basis of the law applying to their institution or the Governments Account Act. However, this duty may serve to signal financial problems but it does not solve them. In only one case can the State help: if a municipality has financial problems. Pursuant to Art. 12 Financial Relations Act, ministers can award a municipality in financial distress an extra benefit from the Municipalities Fund (a state fund for municipalities). Many provisions are involved, the effect being that the municipality is basically placed under tutelage and more or less administered by the Ministry of the Interior. In the Netherlands, five municipalities currently have Art. 12 status. However, this instrument only applies to municipalities. As regards private-law entities, this is not an option, nor is it in the rest of the decentralized structure of the state (e.g., provinces and water control

Legal Acts Governed by Private Law], in: S.C.J.J. Kortmann e.a. (red.), *Vertegenwoordiging en tussenpersonen* [Representation and Intermediaries], Deventer: W.E.J. Tjeenk Willink 1999, pp. 521 ff.

25. See the Memorandum *Vormgeving en toepassing van het instrument van spontane schorsing en vernietiging* [Form and application of the instrument of spontaneous suspension and annulment], *Kamerstukken II* 21 427, no. 21.

boards).

6. As from what time is an entity to be considered as insolvent; is it necessary that the financial difficulties are of a long-term nature or of a structural nature?

The fact that a legal entity's debts exceed its assets does not necessarily lead to insolvency under Dutch law. What counts is not the entity's solvency but its liquidity position: when it can no longer pay its due debts, a situation of insolvency within the substantive meaning of the law. It is then in a state of having ceased to pay its debts, as it is referred to in the first articles of the Bankruptcy Act. A court decision formalizes this situation, taking into account the requirements of the Bankruptcy Act.

7. What are the measures to cope with insolvency: by the entity itself (raising taxes; selling property, etc.); by the State (direct management of the finances of the entity in lieu of the entity itself); by the creditors (recourse to the public authorities or to a judge); what are the relations between the measures?

It is relatively easy to prevent insolvency. As soon as a government body is in financial trouble, with expenditure structurally exceeding income, there are roughly two possibilities (or a combination of the two): increasing income and reducing expenditure.

However, it must be borne in mind that it is not always possible to simply force up income. If income from market activities is involved, then considerations of competition play a role. If the income has a public basis (taxes, levies, etc.), it is not always possible to increase it. This depends on the possibilities offered by the rules regulating the power to levy. Furthermore, this type of income cannot be increased unrestrictedly because that would infringe principles of a public-law nature.

The practice of the above-mentioned Art. 12 procedure contains both elements. Often, a municipality is obliged to increase its income while limiting its expenditure (e.g., a halt on vacancies)

8. May the private creditors require that an entity be declared bankrupt (and hence be dissolved); if not, what are the remedies at their disposal: forced sale of property of the entity; negotiating an agreement with the entity to provide for delays in the payment of interests or in the repayment of the capital, to consolidate interest and capital; to remit part of the debt, etc.?

In the Netherlands, insolvency of government bodies and application of insolvency legislation (still) has not crystallized out, despite the recent events and developments involving the position of public bodies. Therefore, this question cannot be easily answered. First, it must be noted that the Bankruptcy Act does not exclude 'government authorities' from its scope of application. Previous reports also contained a plea for the application of insolvency legislation for the simple juridical reason that it is nearly impossible to distinguish 'government' from 'non-government'. Legal forms and activities are too intermingled. It was argued above that - in the case of concrete organizational forms or key government activities - public-law mechanisms should be incorporated in legislation which either prevent an insolvency situation or prevent the tension between the rationale of the insolvency rules and public policy. In the latter case, one may think of revocation of a public-law power or of the principal duty to continue particular activities.

9. *Is the State jointly (subsidiarily) liable for the debts of the entity? By definition, in certain cases, or only when so provided in the law creating the entity?*

In principle, the State is not liable for the debts of another public body. This could be different, in extreme circumstances, in the case of an entity governed by private law. To prevent misuse of legal entity status, Book 2 DCC includes rules on joint and several liability for administrators when the insolvency of the legal entity is largely due to bad management and administration (see Arts. 2:50a DCC for associations, 2:138 DCC for public companies limited by shares, 2:248 DCC for private limited companies, and 2:300a DCC for foundations). Equally liable is the person who determines the policy, i.e., an administrator who has co-determined the policy of the management. In special circumstances, it is conceivable that the State is considered a 'co-policymaker', but this would involve extremely special situations. There are no similar provisions for entities governed by public law. Finally, the State could be held liable on the basis of tort, should it have behaved in a manner which is contrary to due care vis-à-vis the creditors of the public entity.

10. *Have the creditors who suffer losses in their relations with the entity a legal action against the internal auditors, the external auditors or the State as employer of the public comptrollers for failure in their duties?*

Here, a distinction must be made between internal and external controllers. As regards the position of internal controllers, it must be borne in mind that they are not the decision makers. In case of disfunctioning, an internal controller may of course be dismissed, but no liability exists for lack of a causal link. External controllers are those who draw up and/or audit the accounts of a legal entity. The usual professional liability applies to them. In certain circumstances, this can lead to liability for damages, but it will not automatically lead to recourse for creditors who are not completely indemnified after an insolvency.

11. *Is the situation different as regards private corporations or other private law bodies dominated by the State or used by it in pursuance of public interest?*

At the beginning of this concluding section, we explained that we have discussed these categories integrally in par. II-IV of this report. As in fact observed in the above, there are no principal differences between the two organizational forms.

12. *May the members of the organs of an insolvent entity be subject to criminal prosecution in certain cases?*

Criminal prosecution not only requires applicable criminal law but also a criminal act. In this case, this would be prejudicing creditors or other claimants as referred to in Title XXVI of the Dutch Criminal Code (Art. 340 *et seq.*). This would require a clear criminal act by a director of a legal entity, although the relevant provisions were not written to apply to entities governed by public law. The mere fact that a legal entity goes bankrupt, even in the event of bad administration that can be imputed to an individual, does not constitute a criminal act. In administrative practice, it appears that criminal law is really an *ultimum remedium*. With financial problems, in particular where public bodies that are legal entities governed by public law are concerned, the emphasis is first and foremost on political accountability,

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then private accountability, and finally criminal accountability.