CEU CENTRAL EUROPEAN UNIVERSITY

# The City of Freetown Financial Crisis: Legislating for Municipal Insolvency in Sierra Leone through the Lens of Chapter 9 of the United States Bankruptcy Code

by Michael Imran Kanu



LL.M. SHORT THESIS
COURSE: Comparative Bankruptcy Law
PROFESSOR: Tibor Tajti
Central European University
1051 Budapest, Nador utca 9.
Hungary

**Abstract**

Modern day cities tend to operate much like companies (corporations) rather than merely as another strata of the executive arm of government, clothed with full sovereign powers and privileges, including state immunity. Cities engagement in commercial activities in the discharge of their obligation under the social contract have made them susceptible to the usual problems faced by corporate bodies, including debt default and insolvency.

When cities go broke, the law should provide mechanisms for dealing with such a phenomenon in the least problematic or hazardous way possible. There are two main recognized systems of dealing with debt problems of cities, and that is either the bargain based debt adjustment through insolvency law; or through bailout by the central or federal governments via constitutional or administrative law. Sierra Leone has no municipal insolvency law and has relied on bailout overtime made possible by administrative law.

To all intent and purposes, Freetown, the capital city of Sierra Leone, went broke in 2011. In the wake of this occurrence, this thesis examines the principles and elements of municipal insolvency through the lens of Chapter 9 of the United States Bankruptcy Code, and equally assesses the needs and benefits of adopting such a system in Sierra Leone. In doing so, this thesis employs both doctrinal and comparative law methods in addressing the effectiveness of the present fiscal arrangement of the City of Freetown. It finds that the present system creates an imbalance between the interest of municipalities and that of their creditors, and concludes that the use of municipal insolvency reduces the political and moral hazard associated with central government bailout and incentivize creditors for more lending at an economic rate.

**Dedication**

In memory of Dr. Sheik Umar Khan (virologist) and the thousands of precious souls lost to the Ebola outbreak in Sierra Leone, Guinea and Liberia (2014 - 2015).

**Table of Content**

**List of Abbreviations**

| | |
|---|---|
| ACA | Anti-Corruption Act 2008 |
| ACC | Anti-Corruption Commission |
| AFRC | Armed Forces Revolutionary Council |
| CBA(s) | Collective Bargaining Agreement |
| NDP | National Decentralization Policy |
| FCC | Freetown City Council |
| GoSL | Government of Sierra Leone |
| LGA | Local Government Act 2004 |
| Le | Leones |
| NASSIT | National Social Security and Insurance Trust |
| NRA | National Revenue Authority |
| RUF | Revolutionary United Front |
| US | United States, United States of America |
| U.S.B.C. | United States Bankruptcy Code |
| USD | United States Dollars |

# 1. Chapter One: Introduction

## 1.1 Background

In October 2011, the Anti-Corruption Commission,[1] based on allegations of failing to pay taxes, and employees' social security contributions amongst other offences, indicted the Mayor of Freetown,[2] capital city of Sierra Leone, together with key members of his Management Team. This ought to have been a normal criminal case of usurpation of public funds by the public officers, and a stereotypical corruption story, save for the bold defense of the indigent state of the city the accused persons relied upon.[3] In the realm of insolvency law[4] such disclosure leads only to one probable conclusion, that is, the city is broke. At the material time, though the city could in truth be insolvent, insolvency remedy for municipalities was and is still unknown in law in Sierra Leone.

Generally, corporate insolvency and individual bankruptcy are recognized and provided for by the law in Sierra Leone. The Companies Act of 1960, for example, 'had provisions for the liquidation of insolvent companies'[5] at the time. The 1960 Companies Act was repealed and replaced by the Companies Act 2009, and the new legislation, which was reformative in nature, brought in a number of changes to the corporate insolvency law. The legislative reforms



[1]The Anti-Corruption Commission is an autonomous governmental body established by the Anti-Corruption Act, 2000 repealed and replaced by the Anti-Corruption Act 2008, with the statutory mandate *"to prevent, investigate, prosecute and punish acts of corruption and corrupt practices and to provide for other related matters"*. See the Anti-Corruption Act 2008 <http://www.sierra-leone.org/Laws/2008-12.pdf> accessed 4 March 2015.

[2] The Indictment was preferred by the Anti-Corruption Commission, signed by the Commissioner, Joseph Fitzgerald Kamara, pursuant to section 89(1) of the Anti-Corruption Act, 2008. The key management members of the Freetown City Council also indicted included *inter alia* the Chief Administrator, who by his function was vote controller of the City, the Deputy Chief Administrator, the Acting City Treasurer, the Development Planning Officer, and the City Engineer.

[3] Yada H. Williams, Final Written Address on behalf of the 1st Accused, Hebert A. G. Williams, the *State vs. Herbert A. George-Williams & Others* [2012], High Court, unreported.

[4] Reference to insolvency law goes beyond the scope of insolvency in England, which restrict it use to corporate entities, and will include the general gamut of insolvency or bankruptcy as known in the United States of America. The term insolvency (derived from English law) will be used interchangeably with the term bankruptcy law where necessary and unavoidable in this thesis. When reference is made to Sierra Leone law insolvency will be used save for reference to individuals where the term bankruptcy is the appropriate term. When reference is made to the United States of America law, the term 'bankruptcy' will be utilized in this thesis.

[5]H. M. Joko Smart, "*Sierra Leone National Report*" in K. Zweigert and U. Drobnig *(eds), "International Encyclopedia of Comparative Law Series: Instalment 37",* (Brill, 2003), S-50.

notwithstanding, the 'Doing Business Report 2015'[6] shows that 'resolving insolvency'[7] is quite a challenge in Sierra Leone, given its low ranking in the various indices.[8] Perhaps, *inter alia,* the lack of rescue culture in the Companies Act of 2009 and the Bankruptcy Act of the same year may be responsible for the low ranking.

On a quick assessment of the reformative enactments in 2009, one can safely conclude that progress was made with respect to corporate insolvency, 'with new provisions for arrangements, compromises and re-organization enabling financially stressed companies to restructure or re-organize before going directly to liquidation'.[9] There was considerable progress with respect to individual bankruptcy as well, regarding priority rules and distribution of the bankrupt estate. Thus, the enactment of the Bankruptcy and the Companies Acts in 2009 gives a perspective of a 'glass half empty or half full'. Whilst there may be complete bankruptcy legislation for natural persons and partial provisions for companies, municipal insolvency is relatively unknown in Sierra Leone. With this being the case, the problems of grab law (race of the most diligent creditor), free riding, sovereign protection and the moral hazard are the problems encountered in the system.

In comparison, the US bankruptcy system is rooted in its Constitution, and municipal bankruptcy forms an integral part. It was the awareness of the drafters of the US Constitution of the usefulness of bankruptcy to commerce; and its unusual characteristic of being both a creditor's remedy and a protective shield for the debtor that led to its inclusion in the Constitution.[10] One could properly surmise that one of the goals of the US bankruptcy system



[6] World Bank Group, *"Doing Business 2015: Going Beyond Efficiency."* [DOI: 10.1596/978-1-4648-0351-2], <http://www.doingbusiness.org/~/media/giawb/doing%20business/documents/profiles/country/SLE.pdf> accessed 2 March, 2015.
[7] *Ibid*
[8] World Bank Group, *"Doing Business 2015: Going Beyond Efficiency."* [DOI: 10.1596/978-1-4648-0351-2], pp.80-81, <http://www.doingbusiness.org/~/media/giawb/doing%20business/documents/profiles/country/SLE.pdf> accessed 2 March, 2015.
[9] *Ibid*
[10] See C. Warren, "*Bankruptcy law in United States History*", (1935); cited by Thomas H. Jackson, *"the Logic and Limits of Bankruptcy Law"*, (Beard Books, 2001), pg. 1.

is to keep businesses and by extension municipalities operational even in liquidity crises. The thrust of bankruptcy law is the principle of a shared and controlled debt collection solution. The application of the principles and elements, however, have led to the concretization of the 'fresh-start policy' at its core.[11]

With specific reference to municipal bankruptcy in the US:

> "[T]he basic purpose of Chapter IX is to provide a means whereby municipal financial adjustment can be effected with the approval of the majority but not necessarily all of the creditors. The financial adjustment is attained by… A plan of composition… accepted by creditors owning at least 51 per cent of the securities affected by the plan … the court may confirm a plan of composition that has been accepted by the holders of at least two-thirds of the aggregate amount of all court-allowed claims of all creditors affected by such a plan ..."[12]

This thesis will focus on some of those elements peculiar to municipal bankruptcy in the US, which has made it a useful tool for keeping municipalities financially viable whilst at the same time limiting any systemic risk or moral hazard. The US municipal bankruptcy system is paradigmatic for the negotiation based approach, fostering a commercial debt adjustment for municipalities instead of the alternative of bailout which engenders the moral hazard.

### 1.2 Thesis Objective and Scope

The objective of this thesis is primarily to examine the principles and elements of municipal insolvency through the lens of Chapter 9 of the U.S.B.C., and equally assess the need and benefits of adopting such a system in Sierra Leone. In doing such an assessment, this thesis addresses the effectiveness of the present fiscal arrangement of the City of Freetown; whilst at the same time examining the likelihood of using municipal insolvency as an additional layer to bolster such fiscal and political arrangements already in place. The U.S.B.C., Chapter 9 serves as the model in the assessment of the benefits of what municipal insolvency offers. Central to



[11] Thomas H. Jackson, "*the Logic and Limits of Bankruptcy Law*", (Beard Books, 2001) pg. 1-6.
[12] George H. Hempel, "*An Evaluation of Municipal "Bankruptcy Laws and Procedures*", [1973], the Journal of Finance Vol. 28, No. 5, pp. 1339-1351, 1341 <http://www.jstor.org/stable/2978769> accessed: 6 March 2015.

the Chapter 9 (municipal debt adjustment) application is the negotiation based approach, which employs certain unique features. Consequently, this research answers the principal question of whether the negotiation based approach will work in Sierra Leone, and if it does, what concrete problems will it resolve. The scope of this thesis will therefore be limited to the consideration of the elements or features that form the basis of the negotiation based approach in resolving municipal insolvency.

### 1.3 Thesis Methodology

This thesis is a desk review employing the legal doctrinal research and comparative law methodologies. It will be initially descriptive in nature whilst gradually metamorphosing into an analytic paper in the second part. The initial descriptive part introduces the historical and political events that led to the impecunious state of the city of Freetown. It further describes the legal system in Sierra Leone and the basic building blocks of the US municipal bankruptcy system; and hence provides a conceptual foundation for the comparative sections where elements of the United States municipal bankruptcy will be analyzed to bring out the beneficial elements. The analytical part will contain argumentations from both legal and political perspectives.

The doctrinal method being the traditional method of legal studies in common law systems will be useful especially when elements of a law are examined with the aim of exporting such elements to another legal system. Terry Hutchinson argues that: '[D]octrinal research has been the dominant method used by legal research scholars within the common law system for the last centuries, and this methodology constitutes the foundation or starting point of most legal research projects.'[13] The comparative legal method is used in this thesis to evaluate the US bankruptcy system and its elemental benefits with the goal of their exportation into the system

[13] Terry Hutchinson, "*Doctrinal Research, Researching the Jury*", in Dawn Watkins et. al (eds) "*Research Methods in Law*", (Routledge, 2013), p.27-28.

in Sierra Leone. The debate on whether comparative law is a topic or a legal research method is ongoing;[14] however, it is a valuable approach to employ where two or more jurisdictions form the basis of an academic discourse. The objective of its use will be twofold: It will highlight the differences in the US system to that of Sierra Leone, thereby demonstrating the need to fill the gap in Sierra Leone; and will serve as a guide towards developing a similar system in Sierra Leone.

### 1.4 Thesis Structure

This paper will be divided into six chapters. **Chapter I** is the introductory chapter outlining the background to the thesis, whilst discussing the thesis objective, methodology and structure. **Chapter II** logically builds from the introductory chapter in describing the relevant historic and factual matters that led to the City of Freetown's financial crisis; giving an overview of the political and governing structure of the FCC, a description of the present financial/debt problems of the Council, a local government (municipal) entity in Sierra Leone; the basic building blocks of the U.S.B.C., and the municipal insolvency gap in the law in Sierra Leone. **Chapter III** is the foundation for the legal analysis in the subsequent chapters and contains a brief overview of the legal system in Sierra Leone, its connection and probable dependency on the English legal system, including its perceived historic stigmatic perception of insolvency. This chapter also gives as insight into the solution proffered by the present insolvency law relating to corporate insolvency and individual bankruptcy. **Chapter IV** will examine the concept of municipal bankruptcy in the US, its rationale, it essential elements and features. This is the meat of the comparative analysis as the chapter justifies the selection of the US through the analysis of its features. **Chapter V** analyzes the municipal bankruptcy features in the US in terms of how they could applied in Sierra Leone, with the view of suggesting a viable



[14] See Geoffrey Samuel, "Comparative law and its Methodology", in Dawn Watkins et. al (eds) "*Research Methods in Law*", (Routledge, 2013), p.100, on the question of the whether comparative law is either a topic or a method.

alternative to the present arrangement. It contains the recommendation of this thesis. **Chapter VI** is the concluding chapter of this thesis.

## 2. Chapter Two: Freetown City Council, Its Financial Crisis, and the Basic Building Blocks of the United States Bankruptcy System

### 2.1 An Overview of the History and Political Governing Structure of the Freetown City Council

The city of Freetown has a long and illustrious history. It was the settlement for the emancipated slaves known as the Black Poor and the Maroons from Great Britain, the United States and Nova Scotia in Canada respectively. It is the largest city and also capital of Sierra Leone situated on the Atlantic coast; strategically it boasts the third largest natural harbor in the world, driving it economic activities.[15] "During the second half of the nineteenth century, Freetown was gloriously described as the 'Athens of West Africa' for its highly westernized buildings, services, enterprises, educational institutions, and civic life."[16] Freetown continued it political and commercial dominance when at Sierra Leone's independence it became the political and commercial capital under a unitary central-government political system. The city itself had already been made a municipality led by a Lord Mayor in Council with ward counselors.[17] It continues to be the center for all administrative, economic, social and cultural activities in Sierra Leone.

After Sierra Leone's independence in 1961, Freetown faced a steady economic decline and eventually lost its eminence when it was subjected to an extraordinary ferocious invasion by AFRC fighters and rebels of the RUF, during the civil war in Sierra Leone.[18] The downward slide for Freetown followed the national collapse before and after the end of the civil war.

> "Sierra Leone was one of the world's poorest countries when the civil war began in 1991. In spite of its remarkable strides and reforms since the war ended in 2002, problems of poor infrastructure -- including roads and energy -- low capacity, youth unemployment, high maternal and infant mortality, widespread rural impoverishment, impact of the global economic downturns, and lapses in public financial management

[15] Abdul Karim Bangura, "*Freetown*" in Fitzroy Dearborn (eds) "*Encyclopedia of African History*", (Taylor & Francis Group, 2005) Vol. 1 (A-G).
[16] *Ibid*, p.913.
[17] 'Freetown City Council was created by the Freetown Municipality Ordinance of 1893'.
[18] "*Witness to Truth : Final Report of the Truth and Reconciliation Commission, "the Military and Political History of the Conflict"* (Human rights cases online, 2004), Vol. 3A, p.316, para. 971-1030, <http://www.sierra-leone.org/Other-Conflict/TRCVolume3A.pdf> accessed 3 March 2015.

> and governance still persist. There is also the daunting challenge of enhancing transparency in managing the country's vast natural resources".[19]

In 2004, the Local Government Act[20] (LGA) was enacted to *inter alia* 'provide for the decentralization and devolution of functions, powers and services to local councils and for other matters connected therewith'.[21] Freetown was specified under section 2 of LGA and Part 1 of the First Schedule as a locality[22], which connotes 'the administrative area of a local council[23] and includes a district, town, city or metropolis.'[24] It is important to state that local councils were duly recognized with separate legal personalities being 'bodies corporate with perpetual succession and common seals and may sue and be sued in their own names'.[25] Local councils were endowed with 'powers for the discharge of all of their functions, to acquire and hold movable or immoveable property, to dispose of such property and to enter into any contract or other transaction'.[26]

The LGA made provision for the election of a chairperson[27], 'such number of councilors from the locality, elected by universal adult suffrage every four years with a minimum of twelve members in each council.'[28] Local councils are the premier governmental bodies vested with political powers in their constituencies.

---

[19] The World Bank Group, "*Sierra Leone Overview*", (Last Updated: Nov 01, 2013), <http://www.worldbank.org/en/country/sierraleone/overview>11 January 2014.

[20] The Local Government Act No. 1 of 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[21] Preamble of the Local Government Act *Supra*, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[22] Locality, city, metropolis are used severally in the Local Government Act 2004, and reference to any of the three equates to municipality in the United States of America.

[23] Note that local council equates to the definition of municipality under Chapter 9 of the U.S.B.C. and it will be used interchangeably in the thesis.

[24]Section 1 of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[24] Preamble of the Local Government Act No. 1 of 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[25] Section 3 (1) of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[26] Section 3 (2) of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[27] "Chairperson" means "a person elected in accordance with section 11 or 125 and includes a mayor in the case of the Freetown City Council" (see section 1 of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

[28] Council in each locality shall also include "the number of Paramount Chiefs in a locality as specified in Part II of the First Schedule of the Local Government Act 2004 selected by the Paramount Chiefs in the locality to represent their interests." This does not apply to Freetown, which does not have a Paramount Chief. (See sections 4, 5 and 11 of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.

> [The vested] "legislative and executive powers to be exercised in accordance with the Local Government Act or any other enactment, and are responsible generally for promoting the development of the localities and the welfare of the people in their localities with the resources at its disposal and with such resources and capacity as it can mobilize from the Central Government[29] and its agencies, national and international organizations, and the private sector."[30]

Local councils are to be 'financed from their own revenue collections, from Central Government grants for devolved functions and from transfers for services delegated from Government Ministries'.[31]

### 2.2 National Decentralization Policy and GoSL Bailout

One of the key reasons for the consolidation of the 2004 Act for local governments was to provide for decentralization of governance from the Central Government to the various localities. An 'Inter-Ministerial Committee on Local Government and Decentralization'[32] was set up to spearhead the process of devolution, decentralization and the promotion of local democracy. The policy itself is informed chiefly by the 'Report of the Sierra Leone Truth and Reconciliation Commission'[33] which noted that:

> "The process of decentralisation is intended to ensure that political power and the activity of government should impact positively on all levels of the society. The rationale is that a decentralised system of government allows for better delivery of public services and facilitates constant interaction between politicians, administrators and those they govern. Over-centralisation generally translates into inequity, particularly due to poor service delivery to peripheral regions and the vulnerable sectors of society".[34]



[29] Central Government means the Government of the Republic of Sierra Leone, and mostly refers to the executive arm of Government led by the President except where specified otherwise.
[30] Section 20 of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.
[31] Section 45(1) of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.
[32] Section 109 of the Local Government Act 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 18 January 2015.
[33] "*Witness to Truth : Final Report of the Truth and Reconciliation Commission, "the Military and Political History of the Conflict"* (Human rights cases online, 2004), <http://www.sierra-leone.org/Other-Conflict/TRCVolume3A.pdf> accessed 3 March 2015. See also the Truth and Reconciliation Commission Act 2000, < http://www.sierra-leone.org/Laws/2000-4.pdf> accessed 26 March 2015.
[34] "*Witness to Truth : Final Report of the Truth and Reconciliation Commission, "the Military and Political History of the Conflict"* (Human rights cases online, 2004), Vol. 3A, p.316, para. 971-1030, <http://www.sierra-leone.org/Other-Conflict/TRCVolume3A.pdf> accessed 3 March 2015.

GoSL publicized the National Decentralization Policy (NDP) in September 2010 with one of the objectives to 'to improve local governance by shifting political, administrative and fiscal responsibilities closest to the areas where services are delivered.'[35] It further provides that '[L]ocal councils borrowing and agreements will be consistent with the provisions in the national law'[36] which was only in the drafting stage at the time. Section 3.5.5 (b) of the NDP further provides that: 'Mismanagement of resources by the local councils will not lead to a bail-out from the central government and will be accompanied by appropriate sanctions'.[37] Although the policy is not law, it gives an indication of the intention of the central government and at least bailout was for mismanagement and not in other circumstances where loss maybe as a result of normal commercial or other germen activities. Eventually when the Public Debt Act was passed in 2011,[38] it imposed borrowing limits (in terms of amount and jurisdiction), and reporting duties on local councils. The borrowing limit is pegged on the ability of councils to repay the debts.[39]

The decentralization policy itself was largely for political expediency, implemented within a short timeframe, which essentially left little time for political and administrative training of the elected officials. This followed a period of the breakdown of all political and governance structure in Sierra Leone under an autocratic one party state and the decade long civil war.[40]



[35], Government of Sierra Leone, *National Decentralization Policy*, (Sept. 2010), pp.3 (unpublished).
[36] *Ibid*
[37] *Ibid*
[38] Public Debt Act No. 2 of 2011, <http://www.sierra-leone.org/Laws/2011-02.pdf> accessed 12 March 2015.
[39] Sections 17 and 18 of 'the Public Debt Management Act, 2011': *"17. (1) Subject to this section, a local council may borrow funds only within Sierra Leone, and only up to such limit as may be determined by the Minister. (2) For the purposes of subsection (1), the Minister after consultation with the Minister responsible for local government shall prescribe an annual borrowing limit for each local council based on its capacity to repay and such other considerations as the Minister may determine. (3) Notwithstanding subsection (1), a local council intending to borrow above the limit prescribed in subsection (2) shall obtain prior approval of the Minister through the Minister responsible for local government."* <http://www.sierra-leone.org/Laws/2011-02.pdf> accessed12 March 2015.
"*18. A local council shall submit to the Ministry a record of its borrowing not later than ten working days from the date of signing of a loan agreement or obtaining an overdraft, as the case may be, and shall upon request submit to the Ministry data on its total outstanding debt",* <http://www.sierra-leone.org/Laws/2011-02.pdf> accessed12 March 2015.
[40] "*Witness to Truth : Final Report of the Truth and Reconciliation Commission, "the Military and Political History of the Conflict"* (Human rights cases online, 2004), Vol. 3A, p.47, paras. 35 to 47, <http://www.sierra-leone.org/Other-Conflict/TRCVolume3A.pdf> accessed 3 March 2015. (This part of the Report, under the sub rubric 'Decentralization' gives an account of how the politics of the Central Government destroyed the fabric of local governance in Sierra Leone, leading to the outbreak of the war).

There had been no time for apprenticeship for council members; thus, notwithstanding the provisions for accountability, transparency and financial probity, the local council members, especially the Freetown City Council, were embroiled in financial scandals and management challenges.

### 2.3 The Criminal Prosecution of The Management of the Freetown City Council and Revelation of the City's Financial Crisis

As previously briefly described in the Introduction, the sitting Mayor of Freetown together with key members of his Management Team were indicted in 2011. The Mayor and his team were charged with conspiracy to misappropriate the funds of the City;[41] unlawful failure to pay tax (pay as you earn 'PAYE');[42] unlawful failure to pay national social security and insurance trust contribution;[43] misappropriation of the City funds and revenue;[44] and willful failure to comply with the law relating to the procurement of services.[45]

On the counts dealing with the unlawful failure to pay taxes and national social security and insurance trust contributions, the Commission submitted that the Management of the City, led by the Mayor had a legal duty to pay to the tax authority and the social security trust sums deducted from the salaries of the employees. The failure to do so is penalized by the Anti-Corruption Act 2008. The submission by the Mayor's lawyers was audacious and shockingly simple: The City did not pay the taxes and social security contribution because it was in financial crisis. In their submission to the court, the prosecution wrote:

> "It is the defence case that council lacked funds hence reason why they could not pay the taxes dues of the council staff… The FCC benefitted from loans and overdraft facilities from the First International Bank and Rokel Commercial Bank…Even with

[41] This is contrary to section 128(1) of the Anti-Corruption Act 2008, <http://www.sierra-leone.org/Laws/2008-12.pdf> accessed 4 March 2015.
[42] Contrary to section 48(1)(d) of the Anti-Corruption Act 2008, <http://www.sierra-leone.org/Laws/2008-12.pdf> accessed 4 March 2015 . The allegation is simply that the FCC, through the Mayor and his subordinates deducted the tax from the salaries of employees but failed to pay same to the revenue authority.
[43] *Ibid.*
[44] Contrary to section 36(1) of the Anti-Corruption Act 2008, <http://www.sierra-leone.org/Laws/2008-12.pdf> accessed 4 March 2015.
[45] Contrary to section 48(2)(b) of the Anti-Corruption Act 2008, <http://www.sierra-leone.org/Laws/2008-12.pdf> accessed 4 March 2015.

receipt of the said Five Billion Leones accused persons failed to pay NASSIT and NRA tax obligations".[46]

The trial judge had a different view and stated that, 'in my humble opinion another view could be that it was because the FCC was in financial doldrums that it resorted to loans and overdraft'.[47] The trial judge found that the evidence evinced a conduct of an institution that was willing to pay but had problems with paying.[48]

The charges relating to the unlawful failure to pay taxes and social security contributions were dismissed. What is of significance to this thesis is the admission by the leadership of the City of its broke status. The liquidity of the City was not the only problem, as the heavily collateralized nature of the fixed assets of the City, including the City House, was even more worrying. Could the creditors execute on the assets of the City?

### 2.4 Summary of the Extent of the City of Freetown's Financial Crisis

The criminal case[49] against the Mayor and his team revealed the financial crisis the City of Freetown was embroiled in. The evidence revealed that the City was indebted to financial institutions, governmental institutions and it employees. There was no information about indebtedness to other parties like suppliers and services providers, but it stands to reason that the situation may not have been different.

In seeking to prove its case in the Freetown City Council corruption trial, the prosecution submitted Exhibits SSS1-2 which contains the terms of a short-term loan granted by the Rokel Commercial Bank (SL) Limited dated 5th January 2011 for the sum of Le 5,000,000,000 (Five



[46] Joseph Fitzgerald Kamara et. al, Final Written Address on behalf of the State, the *State vs. Herbert A. George-Williams & Others* [2012], High Court, unreported.
[47] Per J. B. A. Katusi J., Judgment in Hebert A. G. Williams, the *State vs. Herbert A. George-Williams & Others* [2012], High Court, unreported.
[48] *Ibid*
[49] *Ibid*

Billions Leones).[50] Further the prosecution submitted that the Freetown City Council benefited from overdraft facilities from the First International Bank.[51]

With respect to liabilities to NRA, and NASSIT, Abdul Karim Fofanah was the internal auditor who carried out the audit that culminated into the charges had this to say under cross-examination: 'The reason why the City Council did not meet its obligations to NASSIT and NRA is because of the financial constraints they found themselves in'.[52] This testimony was re-echoed by the Senior Administrative Officer in charge of Budgeting, Finance and Finance Committee of the Council, when she confirmed that the Council was in a bad financial state.[53]

Subsequent Governmental action of assigning already devolved functions to other governmental agencies and private institutions also revealed growing mistrust between the Central Government and the Municipality of Freetown. The Central Government took over the functions of waste management and sanitation from the Freetown City Council, and set the tone for delimiting any form of rescue from the Central Government outside the yearly devolved functions' subvention and payment of remunerations.

### 2.5 Brief Outline of Creditors' Remedy (against Municipalities) in Sierra Leone

In general all remedies available against a corporate body are applicable to a municipal debtor in Sierra Leone. Local councils, as aforementioned, have separate legal personalities, being bodies corporate established by statute. Consequently, local councils are not protected under



[50] At the material time, at the exchange rate of Le 4,350 to USD 1, the term loan was an estimated USD1,145,000.00 (One Million One Hundred and Forty-Five United States Dollars). The total transfer from the Central Government to all local councils in Sierra Leone (14) was Le 54,860,000,000.00 (Fifty Four Billion Eight Hundred and Sixty Million Leones), an estimated USD 12,600,000.00 (Twelve Million Six Hundred Thousand United States Dollars. The distribution to councils are *"…determined on the principal of 'equity.' Equity was not defined in the law but, in practice, transparent formulas based on population and existing infrastructure were devised and are being used for the horizontal allocation of grants for devolved functions. Additional administrative grants were provided based on expenditure needs and fiscal capacity and indexed to inflation.*" Vivek Srivastava and Marco Larizza, "*Decentralization in Postconflict Sierra Leone: The Genie Is Out of the Bottle*", p.4-5, <http://siteresources.worldbank.org/AFRICAEXT/Resources/258643-1271798012256/YAC_chpt_8.pdf> accessed 2 March 2015.

[51] *Op. cit.* note 46.

[52] *Op. cit.* note 47.

[53] Testimony of Fatmata Mamadi Kanneh, "*Judgment of the Hon. Justice J. B. A. Katusi J.*," the *State vs. Herbert A. George-Williams & Others* [2012], High Court, unreported.

the State Proceedings Act 2000,[54] which deals with the exercise of jurisdiction of claims by or against the Government of Sierra Leone. Claims by or against the Government must be in accordance with the State Proceedings Act; and provides for protective measures of filling a notice of intention to sue for a three months period;[55] and satisfaction of orders against the Government payable by the Accountant-General upon the production of a certificate issued by the order granting the order against Government.[56] The execution provision insulates all Government property situated in Sierra Leone from execution under the general procedure.

In theory, local councils including the Freetown Municipality, could have their properties (inclusive of realty and personalty) enforced against by a 'writ of execution, which includes a writ of *fieri facias*, a writ of possession, a writ of delivery, a writ of sequestration and any further writ in aid of any of those writs'.[57] In practice, this is hardly the case because the Central Government, through the Ministries of Finance and Local Government would guarantee loans especially from financial institutions and often bail out the councils. For liabilities to the tax and social security agencies, the entities would usually go into some payment arrangement, which pegs payment at future revenue collection or subventions. This was confirmed by Festus Dow Thompson, a supervisor at the Income Tax Department at the NRA in *the State vs. Hebert and Others* aforesaid, when he testified that the NRA 'did visit the City Council to enquire about the default…These officials agreed to the liability and promised to pay. After the meeting we contacted the enforcement and debt management unit who entered into a payment plan with the City Council.'[58]



[54]The State Proceedings Act No. 14 of 2000, <http://sierra-leone.org/Laws/2000-14.pdf> accessed 17 January 2015.
[55] Some of the protection includes the requirement to give three months' notice of intention to sue Government pursuant to 'section 2 of the State Proceedings Act No. 14 of 2000', <http://sierra-leone.org/Laws/2000-14.pdf> accessed 17 January 2015.
[56] Section 21 of the State Proceedings Act No. 14 of 2000, <http://sierra-leone.org/Laws/2000-14.pdf> accessed 17 January 2015.
[57] As provided for under order 47 of the High Court Rules, Constitutional Instrument No. 25 of 2007, <http://sierra-leone.org/Laws/High%20Court%20Rules.pdf > accessed 17 January 2015.
[58] Testimony of Festus Dow Thompson, "*Judgment of the Hon. Justice J. B. A. Katusi J.*," the *State vs. Herbert A. George-Williams & Others* [2012], High Court, unreported.

## 2.6 The United States Creditors' Remedies in Brief – Why the Preference for United States as a Benchmark for Comparison

The system in Sierra Leone will be compared with that of the United States because it is considered to be the paradigmatic municipal bankruptcy system. This is the case because the system delegates the resolution of municipal insolvency to bankruptcy law and not to constitutional or administrative law. The system in United States is used as both creditors' remedy and a protection shield for municipal debtors; thus a better balance is achieved compared to the present situation in Sierra Leone. The United States municipal bankruptcy system is a collective negotiation-based approach, which provides for respite for the municipality, whilst the negotiations with the creditors are pursued. Such collective balance is lacking in Sierra Leone. Prior to the enactment of Chapter 9 of the U.S.B.C., there were in theory six possible remedies for creditors:

> "In the absence of federal statutory law, the question of municipal default was governed by state statute and state and federal common law. During this period, the law of municipal bankruptcy was the law of creditors' remedies. Cities could not declare bankruptcy, but they could-and frequently did-fail to pay their debts. Thus, the legal question was: what could the courts do to compel cities to meet their financial obligations? Among the remedies creditors of a municipality might seek were: (1) seizure of city property; (2) judicial oversight of city financial affairs, including limitations on expenditures that would divert funds away from debt service; (3) seizure of private property within the city; (4) state assumption of municipal indebtedness; (5) obtaining a lien on future tax revenues; and (6) imposition of new taxes earmarked for debt service."[59]

There are no huge differences between the pre municipal bankruptcy code creditors' remedy in the US and that of the existing remedies in Sierra Leone at present. Hence it is important to ascertain the reasons why Chapter 9 was added to the Bankruptcy Code and how it works, with the view of examining whether it will be workable and useful in Sierra Leone.



[59] Randal C. Picker and Michael W. McConnell, *"When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy"*, (Spring, 1993), 60 The University of Chicago Law Review, p.425, 429 <http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2722&context=journal_articles> accessed 3 March 2015. Footnote omitted.

It follows that the six aforementioned remedies in theory were not workable in the US and less useful to the creditors and even the municipal debtor.[60] The conceivable solution for creditors was to adjust the debt through negotiations. This is usually difficult to accomplish where there are multiple creditors with varying interests and risks. Dissenting parties would always hold out and therefore it is necessary to have a bankruptcy law for municipalities that will regulate such creditors' adjustment agreements.[61] Hence the basic idea of Chapter 9 of the U.S.B.C., which is to:

> "[P]ermit a financially distressed public entity to seek protection from its creditors while it formulates and negotiates a plan of adjustment of its debts, either extending maturities, reducing interest or principal, or refinancing its debt by obtaining a new loan elsewhere to pay off existing debt, in whole or in part, and to provide a mechanism by which the plan that is to be acceptable to the majority of creditors can be binding on a recalcitrant and dissenting minority."[62]

### 2.7 The Basic Building Blocks of the United States Bankruptcy System

It is fundamentally important to note that the legal system in the US includes federal, state and common law; and that the Bankruptcy Code is federal law which finds its root in the Constitution of the US.[63] This Constitutional Clause gives power to Congress to enact uniform bankruptcy laws, although not necessarily requiring it to do so. The gist of the U.S.B.C. has already been described in the Introduction. It appears bankruptcy enactments seem to be borne of financial crisis from time to time. Over the course of time Congress has taken several legislative steps to enact uniform bankruptcy statutes leading to what is now considered as the Bankruptcy Code.

Scholars have divided the Bankruptcy Code into two main divisions, namely the universal chapters and the operative chapters. The universal chapters are chapters one, three and five; and



[60] *Ibid* at 430-451.
[61] *Ibid* at 451.
[62] Christopher Smith, "*Provision for Access to Chapter 9 Bankruptcy: Their Flaws and the Inadequacy of Past Reform*", (1998), 14 Emory Bankruptcy Development Journal, p.497, 521.
[63] The Constitution of the United States of America, article I,s.8,cl.4.

they cover general provisions, case administration for chapter one and three respectively; and chapter five covers issues of creditors' claims, the duties of the debtor, debtors' benefits and the estate. The operative chapters include chapter seven, dealing with liquidation; chapter nine provides for debts rearrangement for municipalities; chapter eleven covers reorganization; chapter twelve concerns 'the adjustment of debts of a family farmer or fisherman with regular annual income'[64]; chapter thirteen regulates 'adjustment of debts of an individual with regular income'; and chapter fifteen deals with 'cross-border cases and ancillary issues'.[65] The system is supported by a country wide robust United States Trustee system, supervised by the Attorney General of the United States with separate bankruptcy courts.[66]

The focus of the thesis will be Chapter 9 of the United States Bankruptcy Code. Chapter 9, however, piggybacks on Chapter 11, the re-organization chapter. Therefore the fundamental principles and elements will focus on municipal and to some extent corporate bankruptcies. The underlying idea or thrust of bankruptcy law in the United States relating to the aforementioned areas is twofold. On the one hand it provides a corporative creditors' collective remedy against a debtor with limited assets to satisfy all claims, thereby the tendency of individual measures and the race of the diligent which in not cost effective. Also, it provides respite for a debtor who honestly runs into financial trouble and also permits for the possibility of a second chance (fresh start).[67]



### 2.8 The Gap in the Law in Sierra Leone

Joint arrangements or compromises by creditors to satisfy claims against a defaulting debtor, including municipal debtors, outside liquidation are new phenomena in Sierra Leone. It follows

[64] Martin A. Frey and Sidney K. Swinson, "*Introduction to Bankruptcy Law*", (Delmar Cengage Learning, 6th Edn., 2013), p. 10-34.
[65] *Ibid*
[66] *Ibid*
[67] See Barry E. Adler et. al., "*Bankruptcy, Cases, Problems and Materials*", (Foundation Press, 4th Edn., 2007) p. 6-31.

that there is no rescue culture in Sierra Leone. With a legal tradition that is linked to the English legal system, the bankruptcy stigma is quite evident. For incorporated bodies, for example, creditors' liquidation mechanisms have always been present in the company law; and it was only in 2009 that specific provisions for arrangements and compromises were made.[68] Improving the rating of the country in the World Bank's Doing Business, resolving insolvency index is the principal reason for the inclusion of arrangements and compromises in the 2009 Companies Act. It is a halfhearted attempt to import schemes and arrangements under the English companies and insolvency laws.

The possibility of arrangements and compromises under the law is unfortunately not applicable to municipal debtors. The Companies Act and the provision therein are not applicable to municipalities. In practice, municipalities enter into a one-to-one arrangement with a creditor (mostly *ad hoc* and arbitrary), which often is even sanctioned by courts. Therefore most often the stronger and first-to-come creditors will gain the most. Where there are multiplicity of creditors and the potential for holdout by a dissenting minority, there is no legal framework for municipalities to negotiate a plan of adjustment for its debts, in addition to ensuring that the plan, agreed to by the majority may be forced on a headstrong and obfuscating minority.

The Companies Act 2009[69] and the Bankruptcy Act 2009[70] were enacted with the reducing the hurdles of resolving insolvencies for businesses as part of their goals. It appears that the focus was for businesses especially for incorporated companies and persons trading in their names, where there is no separation of legal personalities, to use the legal provisions in the cited legislations under the ease of doing business reform policy. At the period of this reform in the



[68] Sections 478 to 483 of the Companies Act No.5 of 2009 <http://sierra-leone.org/Laws/2009-05.pdf> accessed 17 January 2015.
[69] The Companies Act No.5 of 2009, <http://sierra-leone.org/Laws/2009-05.pdf> accessed 17 January 2015.
[70] The Bankruptcy Act No. 7 of 2009, <http://sierra-leone.org/Laws/2009-07.pdf> accessed 17 January 2015.

law, the wealthiest municipality in Sierra Leone was in financial doldrums, with no collective rescue mechanism in sight.

In conclusion it must be borne in mind that this chapter has briefly given a description of the political structure of the City of Freetown, entailing its historical importance, its economic prominence, and the national policy of decentralization. The narration further showed how the decade long civil conflict and political misrule has led to the City's steady decline culminating in the financial crisis it faced in 2011. With a further overview of the debt crisis and limiting creditors' collective remedy, one is in a better position to see the need for a further or better system to deal with such crisis.

The illustration of the basic building blocks of the U.S.B.C. exudes the features of the paradigm system, elements of which could be exported into the insolvency scheme in Sierra Leone. Going forwards, it must be noted as a matter of fact that no law can be simply "copy and pasted" from one system to another. The chief comparative method will be to identify principles that are exportable and could fit with the legal system of the borrowing jurisdiction. The next chapter will briefly introduce that legal system and the state of its insolvency law. It builds the foundation for the analysis of elements and principles of municipal bankruptcy in the US to be exported where applicable.

## 3. Chapter Three: The Legal System in Sierra Leone and the State of the Insolvency Law

### 3.1 The Legal System in Sierra Leone and Its Anglo-Saxon Roots

It is important to understand the legal system in Sierra Leone and its development in order to contextualize the nature of recent reforms in the Insolvency Law. This also brings out the reason for doing a comparative study of the US municipal bankruptcy system, with the view of examining whether there was a missed opportunity for municipal insolvency in Sierra Leone. It is therefore vital to start with a brief outline of the whole legal system.

The legal system in Sierra Leone is a composite of the Constitution, statute law, the common law (which includes principles of equity) and customary law (which includes Islamic law). Section 170 of the Constitution of Sierra Leone 1991 provides that the laws of Sierra Leone shall comprise:

> "(a) this Constitution; (b) laws made by or under the authority of Parliament as established by this Constitution; (c) any orders, rules, regulations and other statutory instruments made by any person or authority pursuant to a power conferred in that behalf by this Constitution or any other law; (d) the existing law[71]; and (e) the common law."[72]

Sierra Leone has multiple sources of law,[73] a pluralistic system comprising the general law, customary law[74] and Islamic law.[75] The supreme law in Sierra Leone is the Constitution from

[71] 'The Constitution of Sierra Leone' Act No. 6 of 1991 section 170(4) states that: the "*existing law shall, save as otherwise provided in subsection (1), comprise the written and unwritten laws of Sierra Leone as they existed immediately before the date of the coming into force of this Constitution and any statutory instrument issued or made before that date which is to come into force on or after that date*."<http://www.sierra-leone.org/Laws/constitution1991.pdf> accessed 3 March 2015.

[72] Reference to the common law means "*the common law of Sierra Leone, comprising the rules generally known as common law, the rules generally known as the doctrines of equity, and the rules of customary law*". 'The Constitution of Sierra Leone' Act. No. 6 of 1991 section 170(1) & (2) <http://www.sierra-leone.org/Laws/constitution1991.pdf> accessed 20 January 15.

[73] 'The Constitution of Sierra Leone' Act No. 6 of 1991 section 170 (1), <http://www.sierra-leone.org/Laws/constitution1991.pdf> accessed 3 March 2015.

[74] Customary law means: "*Any rule, other than a rule of general law, having the force of law in any Chiefdom of the provinces whereby rights and correlative duties have been acquired or imposed which is applicable in any particular case and conforms with natural justice and equity and not incompatible, either directly or indirectly, with any enactment applying to the provinces, and includes any amendments of customary law made in accordance with the provisions of any enactment*." The Local Courts Act 1963, section 2, <http://www.sierra-leone.org/Laws/1963-20.pdf> accessed 16 March 2015, repealed and replaced by the Local Courts Act 2011, section 11, <http://www.sierra-leone.org/Laws/2011-10.pdf> accessed 16 March 2015.

[75] "*As a system of law, the Sharia does not apply in Sierra Leone in the same way as the general law and customary law; it may apply either as part of statute law or as part of customary law*." H. M. Joko-Smart "*The Place of Islamic Law within the Framework of Sierra Leone Legal System*" (18 African Law Studies, 1980), p.87-102, 88 <http://commission-on-legal-pluralism.com/volumes/18/smart-art.pdf>, accessed 16 march 2015.

which all other laws derive their legitimacy, and must comply with the letter and the spirit of it. Apart from the Constitution and the general law, the other sources of law do not have any meaningful significance with respect to municipal insolvency. Therefore it will only be of relevance to briefly discuss the ambit of the general law in Sierra Leone, its Anglo-Saxon roots and permissibility to a potential municipal insolvency enactment.

### 3.1.1 The General Law

The Local Court Act 2011[76] defines general law to simply mean "the law in force in Sierra Leone other than the customary law".[77] When the phrase general law is employed, it signifies the laws passed by Parliament,[78] the laws of England adopted either initially in the Imperial Statues or the reception clause in the Courts Act of 1965.[79]

Authority to make law is vested in Parliament.[80] This authority gives it residual rights to legislation for matters:

> "[W]hether arising out of this Constitution or otherwise there is no provision, expressed or by necessary implication of this Constitution which deals with the matter that has arisen, Parliament shall, by an Act of Parliament, not being inconsistent with any provision of this Constitution, provide for that matter to be dealt with." [81]

This would meet the definition of law under section 171(1) of the Constitution, and the first ambit of what is described as general law, if the law itself does not cover issues that are customary in nature.



[76] The Local Courts Act 1963, section 2, <http://www.sierra-leone.org/Laws/1963-20.pdf> accessed 16 March 2015, repealed and replaced by the Local Courts Act 2011, section 11, <http://www.sierra-leone.org/Laws/2011-10.pdf> accessed 16 March 2015.

[77] The Local Courts Act 2011, section 1, <http://www.sierra-leone.org/Laws/2011-10.pdf> accessed 16 March 2015. The Local Act 2011 repealed and replaced the 1963 Act which in its section 2 defines the general law to include "*the common law, equity and all enactments in force in Sierra Leone except insofar as they are concerned with customary law"*. The Local Courts Act 1963, section 2, < http://www.sierra-leone.org/Laws/1963-20.pdf> accessed 16 March 2015.

[78] The legislative organ in Sierra Leone.

[79] The Courts Act 1965, section 74.

[80] 'The Constitution of Sierra Leone' Act No. 6 of 1991 section 105, provides that *"Subject to the provisions of this Constitution, Parliament shall be the supreme legislative authority for Sierra Leone."* <http://www.sierra-leone.org/Laws/constitution1991.pdf> accessed 3 March 2015.

[81] 'The Constitution of Sierra Leone' Act No. 6 of 1991 section 109, <http://www.sierra-leone.org/Laws/constitution1991.pdf> accessed 3 March 2015.

This section is very important in that it points out the constitutional authority of Parliament to enact a municipal insolvency law in Sierra Leone. This is a critical argument when one considers the constitutional challenges to the early bankruptcy statutes in the US. The history of municipal bankruptcy law and the Supreme Court's decision to strike down Congress' first law on this subject in the famous case of *Ashton vs. Cameron Water Improvement District No. 1*[82] will be explored in the next chapter of this thesis. Suffice to say that there will not be any such constitutional grey area in Sierra Leone.

The second ambit of the general law covers the laws of England adopted either initially in the Imperial Statutes or the reception clause in the Courts Act of 1965. This is important to the extent that the adoption of laws from England brought about the adoption of policy consideration associated with the law making process. The Imperial Statutes simply adopted a list of statutes operating in England at the time. The next cycle of adoption was based on the reception clause in the Courts Act 1965, which states that 'subject to the provisions of the Constitution and any other enactment, the common law, the doctrines of equity, and the statutes of general application in force in England on the 1st day of January, 1880, shall be in force in Sierra Leone...'[83]The effect of this almost mass adoption of laws from England, especially on insolvency law in general and municipal insolvency in particular will be discussed in the next section of this chapter.



### 3.2 Insolvency Law in England and Its Nexus to Sierra Leone

The notion of bankruptcy for individuals in England could be traced to the infancy of the common law, when the debtor or his property could be seized by the creditor for the debtor's default in repayment. It was not a collective scheme at the time and different procedures applied

[82] *Ashton v. Cameron Water Improvement District No. 1*, 298 US 513 (1936).
[83] The Courts Act 1965, section 74.

to traders and the general populace.[84] The inability to pay off debt and the modern notion of 'an official procedure for the collection and realisation of a debtor's estate for distribution among his creditors generally was first introduced in 1542 by a statute of Henry VIII'[85] ('Statute of Bankrupts').[86]The said statute also enunciated the *pari passu* distribution rules following the sale of the debtor properties. However the stigmatization of the bankrupt was codified and cemented as the law was aimed at penalizing the debtor rather than creating a fresh opportunity to start all over again.[87]

The English bankruptcy law with its long and maybe inglorious history was not applicable to incorporated entities. Insolvency law in England unlike bankruptcy law is exclusively a construction of statute,[88] which is contained predominantly in a combination of enactments starting with the Joint Stock Companies Act 1844, the initial act to authorized incorporation with a separate legal personality. The Joint Stock Companies Winding-Up Act 1844 came after, enabling companies to enjoy bankruptcy provisions like individual.[89]

The principal insolvency legislations in England are the Insolvency Act 1989, amended by the 1994 and 2000 Insolvency Acts; and also by the Enterprise Act 2002. It must be noted that Insolvency law in England is now being influenced by the European Union legal instruments including the European Union Council Regulation on Insolvency Proceedings 2000.[90] Whilst the lettered provisions of the various statutes is not the focus of this thesis, it must be noted,



[84] "*The distinction between traders and non-traders was abandoned in the 1861 Bankruptcy Act, s.69.*" Roy Goode, "*Principles of Corporate Insolvency Law*", (Sweet & Maxwell, Student Edition, 2011), p. 9-10.
[85] Roy Goode, "*Principles of Corporate Insolvency Law*", (Sweet & Maxwell, Student Edition, 2011), p. 10.
[86] "*Statute of Bankrupts, 34 & 35 Hen. VIII, c4*". Roy Goode, "*Principles of Corporate Insolvency Law*", (Sweet & Maxwell, Student Edition, 2011), p. 9-10, fn. 33.
[87] Roy Goode, "*Principles of Corporate Insolvency Law*", (Sweet & Maxwell, Student Edition, 2011), p9-10.
[88] *Halsbury's Statutes of England and Wales*, "*Bankruptcy and Insolvency*", (4th Edn., 2004 Reissue) Vol. 4, , p.812.
[89] Roy Goode, "*Principles of Corporate Insolvency Law*", (Sweet & Maxwell, Student Edition, 2011), p.11.
[90] European Union Council Regulation on Insolvency Proceedings 2000, [(EC) No 1346/2000 of 29 May 2000]. The emergency of EU law as part of the English legal system means Sierra Leone is often stuck to old and probably obsolete English law. This was case with insolvency and bankruptcy until the statutory changes were made in 2009.

however, that the progression of statutory changes often reflected the softening of the stigma perception and the realization that bankruptcy/insolvency is not necessary a bad thing.

The universally accepted underlying theme of insolvency is to ensure creditors' satisfaction in a fair and organized manner; whilst affording the debtor protection from adverse actions from creditors and the opportunity of a fresh start, rescue or restructured relationship. The achievement of this purpose has a resulting public effect, especially when dealing with large companies with significant contribution to economic activities; or a multiple of small companies with same economic effect. In England some of the overriding principles of insolvency and/or bankruptcy include the aforesaid protection of the individual bankrupt and the possibility to retain some necessary property to enable a fresh start; and the rehabilitation of companies with rescue provisions.[91]

Initially under English insolvency law, a hardline was taken when bankruptcy was considered as 'quasi-criminal and even criminal'.[92] 'Lord Kenyon … said, in 1798 in *Fowler v Padget.*[93] Bankruptcy was considered as a crime and a bankrupt in the old laws is called an offender. This was in line with the general view that bankrupts were fraudsters.'[94]This perception made for the obvious psychological difference between, England and United States with respect to the perception of insolvency and the stigma regrettably attached to it.

The previous paragraphs have given an historical insight into the perception of insolvency in England, and it is the considered view of scholars that the stigma has affected the rescue culture which forms the core of the United States Bankruptcy system. Presently there has been moves towards reform in English law. The Enterprise Act 2012 for example has been described as

[91] Andrew Keay and Dr. Peter Walton, "*Insolvency Law*", (2nd Edn., Jordans, 2008), p.22 citing the "*Report of the* Insolvency Law Review Committee: Insolvency law & practice ("Cork Report') Cmnd. 8558 (1982) at paras 191-192."
[92] Andrew Keay and Dr. Peter Walton, "*Insolvency Law*", (2nd Edn., Jordans, 2008), p.8.
[93] *Fowler v Padget* (1798) 7 Term Rep 509; 101 ER 1103
[94] Andrew Keay and Dr. Peter Walton, Insolvency Law, *Supra* p.8. Footnote omitted.

forming 'the prow of a *rescue culture*: a reformed English law featuring…very much like American bankruptcy law'.[95] It is relevant to understand that the view of the Cork Committee commenting that 'the rescue culture was concerned with the preservation of the business',[96] and not necessarily the entities.

The stigma perception and the exclusion of municipal insolvency in England filtered through in Sierra Leone. Before independence in 1961, English law was the law in Sierra Leone, and by adoption of English law and the reception clause in section 74 of the Court Act 1965 the specifically adopted English law became the law of Sierra Leone. Consequently the Companies Act, Cap 249 of the Laws of Sierra Leone was essentially the adoption of the English Companies Act of 1948. The linkage between the English legal system and the legal system in Sierra Leone went beyond ordinary provision of the law, as even the policy consideration forming the basis of the law and judicial decisions were indirectly given effect to in Sierra Leone. The law on insolvency is no exception to this indirect assimilation of law and policy.

It is ironic and discomforting to fathom that Sierra Leone continues to rely on English law as if both countries share similar policy considerations and institutions.[97] The reliance on English law means there is consistent permeation of English jurisprudence and interpretation in the body of laws in Sierra Leone, including often the policy considerations on certain subjects.[98] This accounts for even the perception of insolvency in Sierra Leone and the attachment to the insolvency stigma typical in old English legislations.



[95] Reinhard Bork, "*Rescuing Companies in England and Germany*", (OUP, 2012), p. 52-53.
[96] Roy Goode, "*Principles of Corporate Insolvency Law*", op. cit. p.32.
[97] Sara Kendall, "*Hybrid Justice at the Special Court for Sierra Leone*", in Austin Sarat (eds.) "*Special Issue Interdisciplinary Legal Studies: The Next Generation*", (Emerald Books, 2010), Vol. 1, p.17, <http://www.academia.edu/3539296/Hybrid_Justice_at_the_Special_Court_for_Sierra_Leone> accessed 16 march 2015.
[98] Since law making is largely informed by policy considerations, the adoption of some statutes would also mean that in giving effects to those statutes the original policy consideration will not be lost. This for example will account for the approach to insolvency in Sierra Leone.

### 3.3 Overview of the Policy, State of Insolvency Law, Reforms in Sierra Leone

This section illustrates how the permeation of the English insolvency law and policy has affected Sierra Leone's legislative drive to regulation issues bordering on insolvency. Regrettably the changes came before the movement towards the American style comprehensive rescue culture in England for companies under the Enterprise Act in 2012. This means that the vestiges of the stigmatization influenced the legislative changes in Sierra Leone in 2009. Given that Chapter 11 of the U.S.B.C. applies to municipal bankruptcy, the rescue culture and willingness to negotiate with defaulting municipalities is a prominent factor in enhancing the negotiation-based approach. It will therefore be valuable to discuss some useful features of corporate insolvency and individual bankruptcy brought about by the reforms in 2009. The one conclusion one may draw from the outlay of these features is that some of the principles and concepts in Chapters 9 and 11 of the U.S.B.C. are known in Sierra Leone, and hence exporting the features of municipal bankruptcy within the context of municipal insolvency in Sierra Leone may not be entirely alien.

In 2009, two important legislations touching and concerning insolvency were enacted, and these were the Bankruptcy Act 2009 and the Companies Act 2009. These Acts were part and parcel of the general reform policy after the end of the decade long civil war in Sierra Leone. Before this period, the Companies Act 1960, repealed and replaced by the 2009 Act only made provisions for receivership and company liquidation.[99] Unlike the limited provision for collective creditors' action in terms of winding up for companies, before 2009 individual bankruptcy had to be dealt with under the normal debtor rules, which included the possibility incarceration of the defaulting debtor.



[99] H. M. Joko-Smart *Op. Cit.* (Note 5).

### 3.3.1 Bankruptcy Act 2009

The Bankruptcy Act 2009 'provides for declaring as bankrupt any person who cannot pay his debts of a specified amount[100] and to disqualify him from holding certain elective and public offices or from practicing any regulated profession and for other related matters'.[101] The basic purport of the Bankruptcy Act entails the possibility of collective creditors' satisfaction on the *pari passu* basis, with possibility of discharge of the bankrupt with some level of punishment by non-participation in politics or from practicing regulated professions like law. The framework includes the commencement of a bankruptcy petition by just a creditor, if the conditions are met.[102]

What follows the petition and a receiving order against a debtor, (wherein the receiver is appointed), is the general meeting of creditors which is the first meeting of creditors.

> [The meeting is]"held for the purpose of considering whether a proposal for a composition or scheme of arrangement is acceptable, or whether it is expedient that the debtor is adjudged bankrupt, and generally as to the mode of dealing with the debtor's property".[103]

Therefore the prospect for compromises and arrangements out of court is possible at the earliest opportunity. Clearly there are some elements of creditors' meeting with possibility of compositions or scheme of arrangement to be reached. These arrangements promote restructuring and rescue and effecting similar provision for a municipal insolvency will be vital.



[100] Le 5,000,000 (Five million Leones) equivalent of USD 1,000 (One Thousand United States Dollars) at the date of writing this thesis.

[101] 'Preamble of the Bankruptcy Act' No. 38 of 2009, <http://www.sierra-leone.org/Laws/2009-07.pdf> accessed 4 March 2015.

[102] The Bankruptcy Act No. 38 of 2009, section 5(1)(a),(b),(c) and (d), <http://www.sierra-leone.org/Laws/2009-07.pdf> accessed 4 March 2015. The condition are: *"(a) the debt owing by the debtor to the petitioning creditor, or if two or more creditors join in the petition, the aggregate amount of debts owing to the several petitioning creditors, is not less than Le5,000,000; (b) the debt is a liquidated sum, payable either immediately or at some certain future time; (c) the act of bankruptcy on which the petition is grounded has occurred within three months before the presentation of the petition; and (d) the debtor is ordinarily resident in Sierra Leone, or within a year before the date of presentation of the petition, has ordinarily resided or had a dwelling house or place of business in Sierra Leone, or has carried on business in Sierra Leone, personally or by means of an agent or manager, or within that period has been a member of a firm or partnership of persons which has carried on business in Sierra Leone by means of a partner or partners or an agent or manager."*

[103] The Bankruptcy Act No. 38 of 2009, section 16, <http://www.sierra-leone.org/Laws/2009-07.pdf> accessed 4 March 2015.

Although a detailed analysis of the Bankruptcy Act 2009 is not within the scope of this thesis, it is important to note that within the broader context of the perception of insolvency, there is a provision for a bankrupt to be discharged.[104] This is, however, limited, and the limitation is connected to the bankruptcy stigma and the responsibility to discharge liabilities.[105]

### 3.3.2 Companies Act 2009

The main purpose of the Companies Act 2009 is to 'provide for the registration and regulation of Companies'.[106] The objectives of the Act ensure that issues of arrangements and compromises with creditors, receivership, winding up, which includes liquidation are also provided for. The corporate insolvency philosophy in the Companies Act affords a creditor the legal right to commence an action (by way of petition) either for the appointment of a receiver, who can be a receiver-manager, or the winding up (liquidation) debtor company upon default. However, once the petition is commenced, it then becomes a representative action for all creditors with the aim of ensuring their satisfaction on a general *pari passu* distribution basis.

Let me reiterate that the discussion on corporate insolvency in Sierra Leone will simply outline some of the features similar to the ones in the reorganization chapter of the U.S.B.C. and nothing more. The focus of the thesis remains municipal insolvency, however, the linkage between Chapter 9 and 11 of the U. S.B.C. makes it necessary to discuss the insolvency features already existent in Sierra Leone.



[104] The Bankruptcy Act No. 38 of 2009, Section 29, <http://www.sierra-leone.org/Laws/2009-07.pdf> accessed 4 March 2015.
[105] *Ibid* section 121(1) states: *"An order of discharge does not release the bankrupt – (a) from any debt or recognizance nor from any debt with which the bankrupt may be chargeable at the suit of the State or of any person for any offence against an enactment relating to any branch of the public service on a bail bond entered into for the appearance of any person prosecuted for the offence; or (b) from any debt or liability incurred by means of any fraud or fraudulent breach of trust to which he was a party, or from any debt or liability obtained by forbearance in any fraud to which he was a party"*. The Act further disqualified a bankrupt from: *"(a) being elected to the office of President, Vice President or Member of Parliament; (b) being appointed as Minister, Deputy Minister, Judge of the Superior Court of Judicature, Ambassador or High Commissioner; (c) being elected as a member of a local council, Mayor, Deputy Mayor, Chairperson or Deputy Chairperson of a local council. (d) being appointed or acting as a trustee of a trust estate; (e) being admitted to practice any profession for the time being regulated by law on his own or in partnership or in any other form of association (other than as an employee) with any other person."* <http://www.sierra-leone.org/Laws/2009-07.pdf> accessed 4 March 2015.
[106] The Companies Act No. 36 of 2009, the Preamble, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.

### i. Arrangements and Compromises

The Companies Act provides for 'arrangements and compromises',[107] albeit with limited scope. The limited scope gives the impression that the inclusion of the enabling part in the Act was an afterthought. For 'arrangements and compromises' to be initiated, a company has to be in a position of being wound-up.[108] The limited scope notwithstanding, the provisions for 'arrangements and compromises' recognize the need to restructure or adjust the debt prior to the commencement of any petition, and also during the process of being wound up. This is similar to debt adjustment planning and composition in Chapters 9 and 11 of the U.S.B.C. respectively.

### ii. Commencement and Eligibility

An insolvent company could be wound up by court, or under the court's supervision, (involuntary winding up); or be voluntarily wound up.[109] The Companies Act states *inter alia*, the incapacity of a corporate entity to meet its debt liabilities as one such prerequisite for the commencement of a winding up petition.[110] This inability is defined to include the failure to pay:

> "(a) If a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding Le2,000,000 then due, … and the company has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor;[111] or (b) if, in Sierra Leone, execution or other process issued on a decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part;[112] or (c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company."[113]



[107] The Companies Act No. 36 of 2009, Part XVII, sections 478 to 483, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[108] The Companies Act No. 36 of 2009, Section 478(6), <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[109] *Ibid* Section 343, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[110] *Ibid* Section 350(e), <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[111] Ibid Section 251(a), <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[112] *Ibid* Section 251(b), <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[113] *Ibid* Section 251(c), <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.

A winding up order, however, 'operates in favour of all creditors and of all the contributories of the company as if made on the joint petition of a creditor and of a contributory'.[114] In recognition of the fact that the Companies Act 2009 is not principally an insolvency specific provision, the rules governing priority in the Bankruptcy Act 2009[115] is relied upon and applicable in certain cases for companies' insolvency.[116]

### iii. Receivership

Under receivership in the Companies Act, a receiver or a receiver and manager of the assets of a company has to be appointed by the court[117] on the request of an interested party, provided that: '(a) the principal money borrowed by the company or the interest is in arrears; or (b) the security or property of the company is in jeopardy'.[118] The appointed receiver of any assets of the corporate concern is entitled to possess the assets and also under the duty to protect same, subject to the lien of previous encumbrances.[119] The receiver may 'receive the rents and profits and discharge all out-goings…and realize the security for the benefit of those on whose behalf he is appointed, but unless appointed manager he shall not have power to carry on any business or undertaking'.[120] It follows that a receiver-manager is permitted to continue the activities of the company much like the trustee may do in the US scenario. I have included this section on receivership because in the following chapters I will argue and make a case for the appointment of a receiver to manage the commercial disposable assets owned by municipalities which could be subject of execution if municipalities default.[121]



[114] *Ibid* Section 360, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[115] The Bankruptcy Act No. 38 of 2009, section 37, <http://www.sierra-leone.org/Laws/2009-07.pdf> accessed 4 March 2015.
[116] The Companies Act No. 36 of 2009, section 438, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[117] Reference to the court herein and in the Companies Act No. 36 of 2009 refers to the High Court of Sierra Leone.
[118] The Companies Act 2009, section 332 <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[119] The Companies Act No. 36 of 2009, section 336(1), <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015. This statutory rule codifies the principle of law derived from the U.S. Supreme Court decision in the famous case of *Butner v. U.S.*, 440 U.S. 48 (1979).
[120] *Ibid* section 336(1) <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[121] See 5.1.1.1(g) of this thesis.

### iv. Automatic Stay, Avoidance Powers and Cram Down

It is important to point out that the Companies Act also contains provision for vital concepts utilized in debts readjustments within the U.S.B.C. that could be useful for municipal insolvency. After the filling of a petition to wind up a company, the court can order a stay on any proceedings against the company on an application by the Company or any creditor or contributory.[122] The difference here is that it is not automatic upon filing as is the case in the US. Further, any disposal of, or execution on assets (in any form) of the said company after the initiation of a winding up proceedings by the court[123] or voluntarily[124] is void. Finally, if an arrangement is reached by a company on the verge of, or being, wound up and three-fourths of its creditors (by numerically or claim), such a plan is enforceable on the rest of the creditors except where the court deems otherwise.[125]

The overall picture painted is that the two Acts[126] have made some provision for creditors' satisfactions and discharge of a bankrupt or winding up / liquidation of an incorporated entity thereby limiting the possibility of grab law and the race of the most diligent. The provisions of the law do not go far enough to address typical insolvency provisions for restructuring or reorganization as in the provisions of Chapter 11 of the U.S.B.C. or the Enterprise Act 2002 in England. What the two aforementioned Acts have done is to provide the basic framework for resolving insolvency with some scintillation of reorganization and negotiation provisions.

Local councils being creatures of statute and not incorporated under the Companies Act 2009 miss out on whatever limited benefits the Companies Act offers. Outside the protection by the Central Government, there is no additional layer of financial support or legal scheme to satisfy



[122] The Companies Act No. 36 of 2009, sections 354 and 381, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015. Section 359 also imposes a stay upon a provisional liquidation order made by the court.
[123] The Companies Act No. 36 of 2009, sections 355 and 356, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[124] The Companies Act No. 36 of 2009, section 406, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[125] The Companies Act No. 36 of 2009, section 427, <http://www.sierra-leone.org/Laws/2009-05.pdf> accessed 4 March 2015.
[126] The Companies Act No. 36 of 2009, and Bankruptcy Act No. 38 of 2009.

creditors collectively. At present, Councils will always go ‘cap in hand’ to the Central Government for bailout when in financial trouble. At this stage it must be getting clearer that the glass can only be considered as half empty with the possibility of being filled with further reforms. What the chapter has achieved is to expose the gap in the law, in terms of the non-applicability of present insolvency law to municipalities. Yet, it has also shown a case could be made with respect to the legality and authority of Parliament to pass laws to govern municipal insolvency. Further, the chapter has illustrated the existences of some features Chapter 9 of the U.S.B.C. in the law in Sierra Leone albeit in corporate insolvency in Sierra Leone.

## 4. Chapter Four: Municipal Bankruptcy Law in the United States of America

The purpose of this chapter is mainly to analyze the integral elements of the US municipal bankruptcy system. The focus will be on why the US system have incorporated such features in the first place, and what role they play in municipal bankruptcy proceedings. This is a useful approach to take because unearthing the reasons for having those features would serve as a guide to their possible incorporation in Sierra Leone.

### 4.1 The Historical Development of Municipal Background

Restating the historical development of municipal bankruptcy in the US brings out the justification of such a system, and helps answer the question of why export and adopt certain elements to Sierra Leone. The aim of this brief discussion on the history is primarily to examine the reason(s) for having such a system and not merely an attempt to retell the story.

The US municipal bankruptcy law was borne out of a crisis. The economic meltdown in the 1930s left municipalities who have been engaging in commercial activities in the same predicament of a debtor who has to deal with numerous creditors on an individual basis.

> "The plight of 4770 municipal units which defaulted in the 1930's was intensified by the lack of orderly legal procedures for facilitating readjustments of the debts. When a municipal unit was in default, it had to obtain the consent of all its creditors to adjust and/or refund the indebtedness. There were no laws to compel minority creditors to agree to any plan of adjustment or refinancing even if the debtor and most of the creditors had agreed to such a plan".[127]

It became apparent that a better system was needed to address the legislative lacuna in dealing with minority creditors' holdout.[128] Reaching a solution given the complexity of the US political and legal systems was a challenge.



[127] George H. Hempel, "*An Evaluation of Municipal "Bankruptcy" Laws and Procedures*", (Dec., 1973), The Journal of Finance Vol. 28, No. 5, p. 1339-1351,1340 <*http://www.jstor.org/stable/2978769*> accessed 6 March 2015.

[128] "*The lack of any legal power of compulsion encouraged the practice of individuals or groups buying up the depreciated bonds of a defaulting community and attempting by the veto of any plan of debt adjustment to realize substantial profits...A municipal default often then led to a long series of acrimonious lawsuits injurious to the community and unproductive in furnishing funds to pay off the creditor*." George H. Hempel, "*An Evaluation of Municipal "Bankruptcy" Laws and Procedures*", (*Supra*) citing Henry W. Lehman, "*The Federal Municipal Bankruptcy Act*," (Sept., 1950), The Journal of Finance, V, No. 3, p. 242.

The first legislation enacted by Congress was the Municipal Bankruptcy Act of 1934,[129] with the purpose of providing a mechanism to adjust the debt liabilities of economically stressed municipalities. The US Supreme Court struck it off as unconstitutional having nothing to do with its economic purpose.[130] The subsequent Act in 1937 with the same purpose and similar content was held to be constitutional.[131] The conspicuous modifications include the non-inclusion of counties and the emphasis on the voluntary character of the scheme.[132] Fundamentally, in my mind, the constitutional debacle affected the possibility of creditors to commence municipal bankruptcy proceedings, and this will be one of the reasons why I would recommend a system in which creditors may commence proceedings within certain safeguards.[133]

The 1946 Amendment Act saw its inclusion as Chapter 9 of the U.S.B.C., and covered 'revenue bonds and authorities and to provide for a preliminary stay of proceedings.'[134] The change in the objectives of the 1976 Act led to a comprehensive system akin to Chapter 11 of the U.S.B.C. That aim led to the introduction of new features like the automatic stay and removal of restrictions on the approval of composition plans. The Act also endowed on the petitioner powers to accept or reject executory contracts, and avoidance. It will be apt to state that the 1976 Act cemented the rescue culture for municipalities similar to those features available for businesses under Chapter 11. It became therefore a confirmation step, when the 1978 Bankruptcy Reform Act incorporated Chapter 11 as part of Chapter 9 by reference.



[129] "The Act was also known as the Summers Wilcox Act". See George H. Hempel, "*An Evaluation of Municipal "Bankruptcy" Laws and Procedures*", *Supra*.
[130] *Ashton v. Cameron Water Improvement District No. 1*, 298 U.S. 513 (1936).
[131] *United States v. Bekins et al.*, 304 U.S. 27 (1938).
[132] See George H. Hempel, "*An Evaluation of Municipal "Bankruptcy" Laws and Procedures*," *Supra*.
[133] See 4.3.1 and 5.1.1(a) of this Thesis on commencement and eligibility.
[134] George H. Hempel, "*An Evaluation of Municipal "Bankruptcy" Laws and Procedures*", *Supra*, p. 1341.

### 4.2 The Justification of U.S. Municipal Bankruptcy Law

The underlying question will be why use municipal bankruptcy and not the known forms under administrative or constitutional law. This section gives an analysis that answers the question of why use municipal bankruptcy and not bailout either under constitutional or administrative law. From the historical economic perspective discussed above, it became quite apparent that the gap in the law in the US was exploited for creditors' profiteering leading to acrimony and municipal unproductivity.

As previously described, the gist of municipal bankruptcy is to provide creditors with a collective remedy based on law and a protective shield for the municipality in debt. The goal is to achieve a balance between the interests of the creditors in getting paid in an organized manner with much efficiency and synergy; with that of the debtor which is protection from predatory enforcement methods.[135]

The alternatives to a system of municipal bankruptcy includes bailout[136] by the Federal or State Government. [137] This method is fraught with constitutional and administrative law problems, especially with respect to its constitutionality and legality. Often taxpayers money is utilized, and the considerations may be more political than fiscal. Often there may be lacking equity, as disparities in treatments of various cities will invoke questions of political injustice. At the end there is always the danger of creating and reinforcing the moral hazard in the system.



[135] See section 1.5 of this Thesis, and Christopher Smith, "*Provision for Access to Chapter 9 Bankruptcy: Their Flaws and the Inadequacy of Past Reform*", (1998), 14 Emory Bankruptcy Development Journal 497,521.

[136] Adam J. Levitin in his paper "*In Defense of Bailout*" "*argues that the choice between bailout and bankruptcy is illusory. Bailouts and bankruptcy are not alternative choices, but an integrated system…"*Adam J. Levitin, "*In Defence of Bailout*", (April 6, 2010), Georgetown Law and Economics Research Paper No. 10-08, Georgetown Public Law and Legal Theory Research Paper No.10-19, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1548787> accessed 20 November 2014.

[137] The historic legal and economic alternatives to municipal bankruptcy are highlighted in section 1.5 of this Thesis, and includes *inter alia* "seizure of city properties, lien on future tax". See also Randal C. Picker and Michael W. McConnell, *"When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy"*, (Spring, 1993), 60 The University of Chicago Law Review, p.425, 430 <http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2722&context=journal_articles> accessed 3 March 2015.

In Sierra Leone, for example, bailouts are not sustainable, as even the national budget is supplemented by donor funding. The chunk of the budget is wages for public workers with a fraction for economic development. After the devolution under the LGA and distribution of the devolved funds annually, the Central Government will not normally be in a position to bailout any local council. In the Freetown crisis, workers went on strike, banks loans were not repaid, citizens refused to pay local taxes because of the City's lacking capacity to deliver on the social contract. Therefore the challenge is not only one of the encouraging the moral hazard (refusal to pay debts), but also one of lacking capacity to bail out financially stressed local government units.

### a. Why Protect Municipal Creditors?

The alternatives for creditors before Chapter 9 was litigation and enforcement, with the appointment of an involuntary judicial receiver or an order of *mandamus*. As described in section 2.6 of this thesis, Professors McConnell and Picker put forward six solutions.[138] The scope of this thesis is not to analyze the solutions, but suffice to say that most were available legally, as they acknowledged only the 'imposition of new taxes earmarked for debt service' [139] was practically and politically applicable. The actual reason to my mind is one of self-existence for the municipalities. Cities cannot increase tax to a burdensome level, however they need money to undertake such key functions as public utilities, school and roads. The failure to raise finance or even pre-finance its works and projects would lead to the City's stagnation. Finding a means to protect creditors, incentivize financiers to lend municipalities at a moderate or



[138] *"(1) Seizure of city property; (2) judicial oversight of city financial affairs, including limitations on expenditures that would divert funds away from debt services; (3) seizure of private property within the city; (4) state assumption of municipal indebtedness; (5) obtaining a lien on future tax revenues; and (6) imposition of new taxes earmarked for debt service."* Randal C. Picker and Michael W. McConnell, *"When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy"*, (Spring, 1993), 60 The University of Chicago Law Review, p.425, 430 <http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2722&context=journal_articles> accessed 3 March 2015.
[139] *Ibid*, pp.429

proportionate risk and interest rate. With such assurances in place there will be the willingness for creditors to lend, and also negotiate if there is a looming default.

### b. Why Protect Municipal Debtors?

When cities face financial holes in their accounts or saddled by debts, often the only tool available to them is raising taxes. Increased taxation has its attendant problems of not only burdening the citizens to the extent of them leaving the city, but may also ignite a financial breakdown injurious to everyone. Increase taxes may also lead to higher rates of criminal behavior. While revenue may be increased, expenses to collect the tax may also increase, due to antipathy towards paying. Further it is beneficial to protect municipalities as they act as trustees of the public and they perform essential services useful for peaceful coexistence. There is no risk greater to the creditors than that of resentment or social upheaval generally or within a municipality.[140] The ensuing section analyses some of the features that ensures that the balancing of the interests of creditors and debtor municipalities are achieved.

## 4.3 Features of Municipal Bankruptcy in United States.

The *sine qua non* features of municipal bankruptcy in the US includes the eligibility requirement, voluntary commencement by the eligible entities, limitation of the powers of the bankruptcy court, automatic stay, debt adjustment plan, avoidance powers, and access to further credit. The main objective in the section is to examine the reason(s) why these features form an integral part of Chapter 9, and how useful they are to the municipal bankruptcy story. The bottom-line will be examining the values of each feature for probable exportation to Sierra Leone.



[140] Randal C. Picker and Michael W. McConnell, *"When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy"*, (*Supra*), pp. 445-449

### 4.3.1 Eligibility and Commencement

The U.S.B.C. provides that a municipality[141] is eligible to seek bankruptcy remedy under Chapter 9. [142] The definition of municipality is wide enough to range from cities to a school district and it must be in an insolvent state[143] within the meaning of the Code to be eligible. The eligibility requirement includes specific authorization by State law or State Authority and the desirability to implement a debt adjustment plan. In manifesting such desire, the municipality ought to have agreed some form of impairment with a class of creditors, attempted good faith negotiations or faced an impracticable negotiable situation.[144] It follows that commencement of bankruptcy proceedings under Chapter 9 can only be voluntary, by the debtor municipality; whilst the creditors are excluded from filing a bankruptcy petition (no involuntary petition).

The eligibility requirement could be viewed and analyzed from two perspectives: Firstly, it represents a compromise which had to be reached by Congress not to run foul of the Tenth Amendment of the US Constitution, which is the non-interference prohibition placed on the Federal Government (including Congress) from interfering into the internal affairs of States.[145]This requirement may be peculiar only to the US and possibly some other federal governments. The threat of unconstitutionality may not be an issues in countries practicing a unitary system of government, including Sierra Leone.

The second aspect deals with deterring the moral hazard. Being insolvent is a requirement to prevent municipalities to simply refuse to pay and take advantage of a possibility of impairment



[141] 11 U.S.C. § 101(40) "The term 'municipality' means political subdivision or public agency or instrumentality of a State", < https://www.law.cornell.edu/uscode/text/11/101> accessed 10 March 2015.
[142] 11 U.S.C. § 109, <https://www.law.cornell.edu/uscode/text/11/109> accessed 10 March 2015.
[143] 11 U.S.C. § 101(32)(c) defines insolvent to means *"(C) with reference to a municipality, financial condition such that the municipality is—(i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due*." <https://www.law.cornell.edu/uscode/text/11/101 accessed on the 10.03.2015> accessed 10March 2015.
[144] 11 U.S.C. § 109 (c) (*Supra*).
[145] See *Ashton v. Cameron Water Improvement District No. 1* and *United States v. Bekins et al* cases, *Supra*.

and even discharge. It has been referred to as "the cash flow insolvency test".[146] Without the test there is the potential to increase the disincentive for creditors, and cut a financing source for municipality. Ensuring an insolvent state and good faith negotiation requirement is a sound and practical financial safeguard valuable to the entire scheme of municipal bankruptcy.

### 4.3.2 Powers and Limits of the Bankruptcy Court

In contrast to the other forms of bankruptcy petitions in the US, the powers of the bankruptcy court are limited. [147] Amongst other things, the municipalities will be debtors-in-possession and continue the management of the municipality, even if, management may have been one of the reasons for the insolvent state. This theory also arose from the sovereignty of States to control their political subdivisions. The bankruptcy court cannot fetter the powers of a municipal debtor in its daily activities as it would in Chapter 11 reorganization *sensu stricto*. The activities of the municipality may include the continuing usage of its properties, incurring more debts, increase revenue generation by increased taxation and even spend money. A trustee cannot be appointed except in special circumstances, for example, where the municipality fails to exercise it avoidance powers.[148]

The statutory limitations enforced on the bankruptcy court also stems from the constitutionality of the court to intervene in matters that will be tantamount to controlling or limiting the political powers of the State. The law does not seek to 'limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise'.[149] This is another constitutional law compromise which may be uncommon in other countries. Whilst



[146] Randal C. Picker and Michael W. McConnell, *"When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy"*, (*Supra*), p. 456.
[147] 11 U.S.C. § 903, <https://www.law.cornell.edu/uscode/text/11/904> accessed 10 March 2015.
[148] 11 U.S. Code § 926, <https://www.law.cornell.edu/uscode/text/11/926> accessed 10 March 2015.
[149] 11 U.S.C. § 903, <https://www.law.cornell.edu/uscode/text/11/903> accessed 10 March 2015.

this may be a valuable compromise in the US in ensuring constitutional order, it may not be the case in countries where the flexibility of the laws gives greater latitude to municipalities as near corporate entities.

### 4.3.3 Automatic Stay

Chapter 9 of the U.S.B.C. incorporates by reference other sections of the Code.[150] Section 362 dealing with automatic stay is so incorporated, and upon filling of a petition, all creditors are estopped from continuing any form of collection action against the municipal debtor.[151] It is quite an extensive tool to wield in giving respite to municipal debtors in financial crisis. It is instantaneous upon the filling of a petition and operates as an order of the bankruptcy court. In addition to the extensive provision in section 362, the stay is extended to actions against an officer or residents of the municipality in pursuing a relief against the said municipality, 'the enforcement of a lien on or arising out of taxes or assessments owed to the debtor'.[152]It must be noted that there is a small exception to the stay under section 922, when dealing with 'pledged special revenues in a manner consistent with section 927 of this title to payment of indebtedness secured by such revenues.'[153]

The automatic stay provides for the order and sanctity in the adjustment process. Creditors, especially businesses, are not by nature altruistic or utilitarian. Their objective is to make profit, which will include enforcing against a municipal debtor with maximum effect irrespective of the disruption it may cause to the debtor's obligations of service delivery. It does not operate one way, that is, merely in favour of the debtor as a protective mechanism. If there are instances where it is fair for the stay to be lifted, a relief from the stay can be granted. It is one of the most



[150] 11 U.S. Code § 901, <https://www.law.cornell.edu/uscode/text/11/901> accessed 10 March 2015.
[151] 11 U.S. Code § 362, <https://www.law.cornell.edu/uscode/text/11/362> accessed 10 March 2015.
[152] 11 U.S. Code § 922, <https://www.law.cornell.edu/uscode/text/11/922> accessed 10 March 2015.
[153] 11 U.S. Code § 922(d) *Supra*.

beneficial features of municipal bankruptcy, and could be valuable to a possible municipal insolvency law in Sierra Leone.

### 4.3.4 Avoidance Powers and Executory Contracts

Avoidance powers gives the municipal debtor the legal right and pragmatic opportunity to set aside legal or contractual commitments, generally preferences and fraudulent transfers, based on a court order.[154]

> [Normally], "[T]he effect of avoidance depends on whether the thing being avoided is (1) an outright transfer of property, or (2) a lien. If an outright transfer is avoided, the trustee then will attempt to recover the property transferred [or it value] under § 550. If a lien is avoided, then the lien will be eliminated".[155]

Under Chapter 9, a trustee can only be appointed under exceptional cases in which the municipality acting as a debtor in possession declines to exercise its avoidance powers.[156]

Further, by reference again through section 901, section 365 of the U.S.B.C. is incorporated and gives the municipal debtor the right to reject executory contracts. Randal C. Picker and Michael W. McConnell argue:

> "As a matter of political reality, the financial situation of a municipality is often directly related to the city's existing contracts with its employees. Collective bargaining agreements with police officers, firefighters, teachers, garbage collectors, and other municipal employees impose substantial financial burdens on municipalities and are often the apparent source of a municipality's current financial difficulty".[157]

CBAs are considered to be executory contracts within the realm of section 365 of the U.S.B.C. by the Supreme Court in *National Labor Relations Board vs. Bildisco & Baldisco*.[158] The test espoused by the Supreme Court in the case tilts in favour of municipalities to reject CBAs if



[154] Charles J. Tabb and Ralph Brubaker, "*Bankruptcy Law, Principles, Policies, and Practice*", (Anderson Publishing Co., 2003), p. 383.
[155] *Ibid*
[156] 11 U.S. Code § 926, <https://www.law.cornell.edu/uscode/text/11/926> accessed 11 March 2015.
[157] Randal C. Picker and Michael W. McConnell, *"When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy"*, (*Supra*), pp. 467,
[158] *National Labor Relations Board vs. Bildisco & Baldisco* 465 U.S. 513 (1984). See *Ibid*

they are burdensome to the estate and good faith steps have been taken to reach an agreement.[159] The treatment of pensions is however, unclear, although it is another burdensome financial liability of a municipality.[160]

The reason for avoidance powers is to reset the position and preserve the estate of the debtor. The idea is to ensure that the municipal debtor is not worse off, and hence the exercise of avoidance to acts that took place very close to the bankruptcy petition that were either preferential or fraudulent. A properly executed avoidance increases the estate and puts more in the kitty for the debt adjustment plan. Similarly the rejection of executory controls could reduce the liabilities and claims against the municipal debtor. Ultimately creditors will be willing to participate, when there is more in the kitty for a *pari passu* distribution rather than a selected preference. This is very much in line with the overall goal of bankruptcy, that is, the provision of an orderly, fair and equal collective remedy.

### 4.3.5 Access to further Credit

Another unique feature of Chapter 9 is the ability of a municipal debtor to finance its activities even in the process of debt adjustment. Section 364 (c), (d), (e) and (f) of the U.S.B.C.[161] incorporated by reference by section 901 permits the taking of more financial liabilities whilst the municipality is in debt adjustment under the cover of administrative expenses with super-priority over other claims. Whilst this provision is pragmatic enough to allow further access to



[159] '*National Labor Relations Board vs. Bildisco & Baldisco*, 465 U.S. 513 (1984). See also *Orange Co. Employees Ass'n v. County of Orange (In re County of Orange)* 179 B.R. 177 (Bankr. C.D. Cal. 1995); and *In re City of Vallejo,* 403 B.R. 72 (Bankr. E.D. Cal. 2009), *aff'd,* IBEW, Local 2376 v. *City of Vallejo (In re City of Vallejo)*, 432 B.R. 262 (E.D. Cal. 2010)'. "*Courts should readily allow the rejection of such contracts where they are burdensome, the rejection will aid in the municipality's reorganization and in consideration of the equities of each case...[e]quities in favor of the city in chapter 9 will be far more compelling than the equities in favor of the employer in chapter 11. Onerous employment obligations may prevent a city from balancing its budget for some time. The prospect of an unbalanced budget may preclude judicial confirmation of the plan. Unless a city can reject its labor contracts, lack of funds may force cutbacks in police, fire, sanitation, and welfare services, imposing hardships on many citizens.*" "Executory Contracts and Municipal Bankruptcy, 85 Yale L. J. 957, 965" (1976) cited by "the Senate Report No. 95–989, Notes to 11 U.S. Code § 926",<https://www.law.cornell.edu/uscode/text/11/926> accessed 11 March 2015.

[160] Ashley Woods, "*Detroit Bankruptcy Ruling By Judge Steven Rhodes Gives City Chapter 9 Protection",* Huffington Post, [December 3, 2013], <http://www.huffingtonpost.com/2013/12/03/detroit-bankruptcy-decision-ruling-rhodes_n_4376775.html?utm_hp_ref=detroit-bankruptcy> accessed 11 March 2015.

[161] 11 U.S. Code § 364 – "*Obtaining credit*", <https://www.law.cornell.edu/uscode/text/11/364> accessed 11 March 2015.

funds, it may be a backdoor to incur more liabilities leading to either the moral hazard or expensive financing with high interest rates that may be unsustainable. It may also impair the value of the estate with its super-priority. This feature is another remnant of the vestiges of constitutional States non-limitation issue.

### 4.3.6 The Debt Adjustment Plan and Discharge

The thrust of Chapter 9 is the debt adjustment plan. The ultimate goal of municipal debt adjustment is to get a plan that is agreeable to a majority of the creditors, even if it means the impairment of some class of debts and cramdown measures imposed on a dissenting minority. The plan may include prolonging the maturity date of the debt, impairment of the principal or interest or new facility to refinance. Outside insolvency, a municipal debtor may be able to adjust its debt with one or two creditors, the scheme under Chapter 9, however, ensures a collective action aided by the coercive cramdown powers to deal with any holdout. The municipal debtor 'shall file a plan for the adjustment of the debtor's debts. If such a plan is not filed with the petition, the debtor shall file such a plan at such later time as the court fixes.'[162]

The exclusive right to file the plan by the municipal debtor is linked to the constitutional prohibition of limitation of State control, thereby shutting out creditors and other interested persons. Once the plan is filed, it needs to be confirmed by the bankruptcy court.[163] 'The test for confirmation is whether or not the plan is fair and equitable and feasible.'[164] This is in addition to the standard set in section 1129 of Chapter 11,[165] incorporated by section 901 of Chapter 9. Crucially the plan when confirmed is enforceable against all creditors including those who do not accept and leads to the discharge of debt in the confirmed plan.[166] The voting

[162] 11 U.S. Code § 941 – "*Filing of plan*", <https://www.law.cornell.edu/uscode/text/11/941> accessed10 March 2015.
[163]11 U.S. Code § 943, <https://www.law.cornell.edu/uscode/text/11/943> accessed 10 March 2015.
[164] 11 U.S. Code § 943 – "*Confirmation*", "Senate Report No. 95–989", <https://www.law.cornell.edu/uscode/text/11/943#FN-1REF> accessed 10 March 2015.
[165] 11 U.S. Code § 1129 – "*Confirmation of plan*", <https://www.law.cornell.edu/uscode/text/11/1129> accessed 10 March 2015.
[166] 11 U.S. Code § 944 – "*Effect of confirmation*", <https://www.law.cornell.edu/uscode/text/11/944> accessed 10 March 2015.

requirement[167] of at least two-thirds in monetary value or more than one-half of the claims allowed and the cramdown though complex are the valuable features not present in non-bankruptcy cases. There is no provision to tame dissention in non-bankruptcy cases, and creditors are prone to act selfishly and destructively if faced with a scenario of a defaulting debtor.

### 4.4 Challenges of Municipal Bankruptcy in the United States – the City of Detroit Case Study

Municipal bankruptcy has its drawbacks in the US. As discussed in section 4.3.1 of this Chapter, the eligibility criteria are quite cumbersome and a disincentive for many municipalities to file a petition. It requires various levels of State (political) control and approval. The requirements are heavily dented by the constitutional issues bordering on the Tenth Amendment reservation of State powers. The eligibility requirements are further complicated by the insolvent test for commencement of an adjustment proceeding. The test is a cash flow, which means if a municipality is in a bad financial situation but still entitled to credit, it cannot commence bankruptcy proceedings. It will not be cash strapped, but it means further accessing funds at a higher interest rate and on unfriendly terms.

Further, the constitutional restrictions mean that most actions are exclusive to the municipal debtor, that is, commencement, avoidance powers, and right to reject executory contracts with little possibility for creditors to initiate action or get a trustee appointed to grow the estate. This creates an imbalance and hence does have a different meaning of "fair and equitable" compared to the balancing of interests in cases under Chapter 11. The ability to borrow money during debt adjustment with super-priority may also mean a leeway to incur debt under the guise of



[167] 11 U.S. Code § 1126 – "*Acceptance of plan*", <https://www.law.cornell.edu/uscode/text/11/1126> accessed 10 March 2015.

administrative expenses. In truth these provisions inhibit municipal bankruptcy filings and depending on the perspective it may not inhibit the moral hazard but rather encourages it.

The long and complex nature of municipal bankruptcy especially for large cities, may also be a disincentive to file a petition. The City of Detroit filed a petition on the 18th July 2013 with debts estimated at $18,000,000,000 (eighteen billion USD).[168] It is still ongoing and has been a long elaborated and complex proceeding. However, on the 7th November 2014,

> "Steven Rhodes, a bankruptcy judge, approved Detroit's plan for the adjustment of debts that will allow the city to slash $7 billion of unsecured liabilities off its $18 billion debt mountain…Under the agreement both pensioners and bond holders will take pain, albeit at varying degrees. The pensions of retirees will be cut by 4.5% and the cost-of-living adjustments (COLA) will go. Retirees from the police force and the fire brigade will have to live with a reduction in COLA from 2.25% to 1%. Health-care benefits will be reduced by 90% for all retirees. Bond holders…had to accept a huge haircut…The exit from chapter 9… gives Detroit some breathing space. But it's only a first step on the long way to recovery".[169]

The case is still ongoing and several orders are being made after the confirmation of the adjustment plan by the 'Bankruptcy Court in the Eastern District of Michigan'.[170]

This chapter has illustrated the salient features of municipal bankruptcy in the US, and further explained why the features form an important part of the system. It is this analysis and reasons that inform the choice of exporting those features, where applicable, to Sierra Leone. The goal will always be to create a less hazardous framework to allow for an orderly and fair creditors' collective remedy, whilst affording some needed protection to municipalities; a debt adjustment system that will not be a disincentive for further financing.



[168] Ashley Woods, "*Detroit Bankruptcy Ruling by Judge Steven Rhodes Gives City Chapter 9 Protection",* Huffington Post, [December 3, 2013], <http://www.huffingtonpost.com/2013/12/03/detroit-bankruptcy-decision-ruling-rhodes_n_4376775.html?utm_hp_ref=detroit-bankruptcy> accessed 11 March 2015.

[169] V.V.B, "*Detroit's bankruptcy plan, A phoenix emerges*", (The Economist, 7 Nov. 2014) <http://www.economist.com/blogs/democracyinamerica/2014/11/detroits-bankruptcy-plan> accessed 11 March 2015.

[170] In re City of Detroit, Michigan, Case No. 13-53846, [2015], "*Order Approving Stipulation to Allow Claim No. 759 as a General Unsecured Claim in a Reduced Amount, (Entered: 03/02/2015)*", <http://www.mieb.uscourts.gov/sites/default/files/detroit/docket9328.pdf> accessed 11 March 2015.

## 5. Chapter Five: Municipal Insolvency in Sierra Leone

### 5.1 Why Introduce Municipal Insolvency in Sierra Leone?

The role municipal bankruptcy plays in the US is clear now. The objective of this chapter is to firstly see how the various elements of Chapter 9 of the U.S.B.C. can fit into the legal system in Sierra Leone; and secondly to put forward solutions which can easily merge into the Sierra Leone system, plucking out the idiosyncratic constitutional compromises which had to be made in the US system.

The underlying question of this thesis, which is, why introduces municipal insolvency in Sierra Leone could be answered by utilizing similar justification for the US municipal bankruptcy law. The overall goal of providing an orderly fair collective remedy for creditors and legal protection for municipal debtor should be the answer in the main, (legal remedy vs. legal protection). This will reduce the opportunity for Central Government bailout and the consequent moral hazard, and provides an incentive to creditors to continue financing local government units.

The NDP is clear on one thing, and that is the outright prohibition of bailout of local government units when funds are mismanaged.[171] This does not, however, overrule bailout from the Central Government for reasons other than mismanagement of funds. Generally, it will economically challenging but a political imperative for the Central Government to bailout local councils. Outside insolvency, it has been explained earlier that when local government units exercised their borrowing powers,[172] such borrowing may be backed by GoSL credit guarantee.[173]
Often the practice is that the Ministry of Finance and the Ministry of Local Government will guarantee a loan from secured and sophisticated lenders. The Central Government guarantee



[171] Clause 3.5.5(b) of the National Decentralization Policy, [September 2010], Government of Sierra Leone.
[172] The Public Debt Management Act, No. 2 of 2011, section 17<http://www.sierra-leone.org/Laws/2011-02.pdf> accessed 16 March 2015.
[173] The Public Debt Management Act, No. 2 of 2011, section 13<http://www.sierra-leone.org/Laws/2011-02.pdf> accessed 16 March 2015.

may not always be ideal as it only shifts the liability and encourages a systemic risk. The only conceivable advantage for the guarantee is the protection of the Central Government under the State Proceeding Act,[174] as earlier described.[175] On the part of the local council, they risk the exercise of the powers by President and Parliament, where the President of GoSL could takeover administration of the local council.[176] From this undesirable financial and political solutions now present, the following sub-sections discuss the municipal insolvency alternative. An alternative that provides debt adjustment that balances the need to protect municipal debtors and provide legal remedy for creditors.

### 5.1.1 Legal Protection for Municipal Debtors and Remedy for Creditors

Local government units are already considered as corporate entities much like companies incorporated under the Companies Act 2009 in terms of their commercial competence. In the second chapter, the features utilized for corporate insolvency were briefly described. In truth, they were not so much different from the features analyzed under Chapter 9 of the U.S.B.C. The examination of the suitability features of the features in Chapter 9 of the U.S.B.C. will inform the recommendation that will follow. At this stage it must be clear that municipal insolvency is a desirable alternative mechanism in Sierra Leone, and the question now is what features will work well in the context of the legal system and political structure?

#### a. Commencement and Eligibility

Under the U.S.B.C. commencement is exclusive to municipalities.[177] The reason for this as previous explained is constitutional (political) rather than based on financial considerations. On the other hand, the Companies Act in Sierra Leone though heavily slanted towards liquidation

[174] The State Proceeding Act No. 14 of 2000, <http://www.sierra-leone.org/Laws/2000-14.pdf> accessed 16 March 2015.
[175] See section 2.4 "*Brief Outline of Creditors' remedy (against Municipalities) in Sierra Leone*" of the Thesis.
[176] Section 100 of the Local Government Act, No. 1 of 2004, <http://www.sierra-leone.org/Laws/2004-1p.pdf> accessed 16 march 2015.
[177] 11 U.S. Code § 303, 901(a).

and winding-up, provides for voluntary and involuntary commencement. The model for Sierra Leone municipal insolvency will be on both voluntary and involuntary right to commence insolvency proceedings, with stipulated eligibility requirements including the inability to meet its debt liabilities. This to my mind is not only a cash flow insolvent state but one that is practical enough to stipulate a specific amount of indebtedness with no capacity to repay.[178]

The U.S.B.C. Chapter 9 eligibility criteria[179] of cash flow insolvency and exclusivity may not be ideal to incorporate in Sierra Leone. Sierra Leone is a unitary system and hence the preservation of State powers under the Tenth Amendment of the US Constitution is an issue. In balancing the interests of the creditors' and municipal debtor, it will be a fair bargain if a percentage of creditors, either in claims or value are able to commence municipal insolvency proceedings within the safeguard of a mandatory pre-petition arrangement or compromises (adjustment plan). Thus there will be a first creditors' meeting, with more of a role envisaged for creditors. The means that the requirement of an adjustment plan, composition, cramdown and negotiation approach under the U.S.B.C. will be useful to adopt in addition to the eligibility of creditors to commence municipal insolvency proceedings.[180]

**b. Powers and Limits of the Court (High Court)**

The equivalent of the bankruptcy court in the US is the High Court in Sierra Leone. It will not be valuable for the powers of the High Court to be limited in the way in which the Bankruptcy Court in the US is.[181] By the very creation under the LGA,[182] local councils have not been afforded any sovereign protection and it will not be in the best interest of reaching a balanced debt adjustment framework to do so now. Discretionary powers have to be given to the High



[178] The Companies Act No. 36 of 2009, section 350(e).
[179] 11 U.S. Code § 109 (c), § 101(40), § 101(32)(c).
[180] This also means the provisions for arrangement and compromises under Part XVII of the Companies Act No. 36 of 2009 will be expended and made more amendable to empathizing negotiations.
[181] 11 U.S. Code § 903 and 904.
[182] The Local Government Act No.1 of 2004, section 3.

Court to deal with issues that will follow from effecting the cramdown, the avoidance powers, automatic stay and even for the appointment of a receiver. A case for the appointment of a receiver and execution on "proprietary property" will be made subsequently in this chapter. It is sufficient to conclude that since the establishing law for local councils made no reservation with respect to claim/suits against it, it should not be the place of any insolvency law to create such limitations.

### c. Automatic Stay

The automatic stay has explained operates like an immediate injunction on all collection actions against the municipal debtor and its assets on the commencement of bankruptcy proceedings in court.[183] Exceptionally, the stay does not apply to revenue earmarked for payment of certain debt liabilities.[184] This is in recognition of the specific contractual obligation by municipalities prior to filing of the petition. Further, creditors have the opportunity to apply for relief from the stay, thus ensuring that there is a safeguard to prevent its abuse. The Companies Act in Sierra Leone preempts the making of an application before a stay is granted.[185] In the circumstances the US position appears to be very satisfactory and beneficial to the preservation of the integrity of the bankrupt estate without reliance on the diligence or skill of the management of debtor, creditors, contributories or their legal counsels. Its adoption in Sierra Leone as practiced in the US is therefore highly recommended.

### d. Avoidance Powers and Executory Contracts

Another typical feature that also deals with the preservation of the estate is the exercise of avoidance powers. In municipal bankruptcy in the US, it will be the management of the municipality, acting as debtor-in-possession that ought to exercise those powers. However,

[183] 11 U.S. Code § 362(a), 901(a).
[184] 11 U.S. Code § 922(d).
[185] The Companies Act 2009, sections 354 and 381.

failure by the bankrupt municipality to exercise sure powers may lead to the appointment of a trustee by the Bankruptcy Court.[186] Avoidance is aimed at curbing preferential and fraudulent payments especially before a looming bankruptcy. The Companies Act in Sierra Leone also makes provision for the exercise of avoidance powers in winding-up by the court or voluntarily.[187] The same or similar provision could me incorporated for local council within the framework of debt adjustment and not winding-up or liquidation as it is in the Companies Act.

On the other hand there is no provision within the Companies Act relating to treatment of executory contracts. Perhaps the bias towards winding up and liquidation is responsible for the lacuna. This gap could be dutifully filled by the treatment of executory contracts in the U.S.B.C., especially under Chapter 9. Given the benefits of having the right to reject, impair or accept executory contracts (already discussed),[188] it will be useful to incorporate it in Sierra Leone.

**e. Access to further Credit**

Under Chapter 9 of the U.S.B.C., municipalities are allowed to incur more debt with super-priority over existing liabilities.[189] Broad powers are given to the debtor municipality to continue tax management, which could include raising taxes, disbursing funds within its coffers, as administrative expenses. This provision recognizes the obligations of municipalities to deliver on the social contract between municipalities and their residents. In my view, without proper court supervision there might be a danger that the debtor-in-possession may engage in practices that lead to financial crises especially when there are no external causes. For Sierra Leone, the NDP has clearly overruled bailout for mismanagement of funds, and the other potential solution could be early disbursement of devolved funds, which could cover

[186] 11 U.S. Code § 926. See 4.3.4 of this Thesis.
[187] The Companies Act No. 36 of 2009, sections 355, 356, & 406.
[188] See 4.3.4 of this Thesis.
[189] 11 U.S. Code § 364, 901(a).

administrative expenses as well. With these special funding it will be vital to see a prudential third party like a receiver-manager administering such funds as a fiscal agent. The fiscal agency would mean political power will still remain with the management of the debtor municipality.

### f. The Debt Adjustment Plan and Discharge

The heart of any municipal insolvency law in Sierra Leone will be confirmation of the debt adjustment plan, with an acceptable level of impairment and discharge of some liabilities.[190] The various features discussed are tools to be utilized to ensure that the adjustment plan is confirmed. The municipal bankruptcy debt adjustment plan borrows a lot from Chapter 11 reorganization for businesses. This is useful to the extent that the municipal insolvency law may also borrow key features from corporate insolvency in Sierra Leone.

The overriding guide in the confirmation of municipal bankruptcy as discussed in 4.3.6 herein is the 'best interest test'. As between the parties the adjustment plan and discharge must be the preeminent solution with no other alternative that is viable. The alternatives presently in Sierra Leone as discussed are either one-to-one *ad hoc* agreements or Central Government bailout. In adopting a negotiation based debt adjustment system, the test will always be whether the collective confirmed plan is better than the existing solutions. Conceptually, this thesis has described and analyzed the theoretical and practical reasons illustrating the superiority of the debt adjustment in curbing the race of the diligent creditor, moral hazard and creditor's disincentive. Therefore legislating for municipal insolvency can only mean the imposition of a collective remedy in place of disorder and bailout.



[190] 11 U.S. Code § 941,943(b), 1129, 901(a).

### g. Role of an Insolvency Receiver, Receiver-Manager and the Question of Execution on Municipal Property.

I have considered the limited role of the trustee in municipal bankruptcy under Chapter 9 of the U.S.B.C., which is more limited than the powers in Chapter 11. The discussion in 4.3.2 and 4.3.4 of this thesis has given some reasons for the limited role of the bankruptcy trustee. The key function of the trustee in Chapter 11 is to supervise the administration of the bankruptcy estate during the reorganization. It must be reiterated that the constitutional challenges in the US are not in existence in Sierra Leone. If the local government units are considered as corporate entities, then it will follow that the Chapter 11 role of the trustees could be adopted to the extent of appointing receiver, receiver-manager in the context of Sierra Leone.

The role of the receiver, the receiver-manager in the corporate sense in Sierra Leone, is to manage the assets of the defaulting company. One of the six solutions in the US, namely, the seizure of property, put forward by Professors McConnell and Picker[191]could be put to the test in Sierra Leone. It will be highly undesirable to allow execution on municipal properties that are not directly used for public utility. Local government units engaged in pure commercial activities, and those assets, whether tangible or intangible, could be made subject of execution and administer by the receiver or receiver-manager. The test and the process will have to be heavily supervised by the High Court to ensure that the public interest is safeguarded. In all, the receiver or receiver-manager will firstly act as a fiscal agent and then as an administrator of the insolvent municipal estate without exercising political power.

### h. Municipal Insolvency Crime and Civil Liabilities

On the whole, the thesis has been premised on the fact that the insolvent state of municipalities is not caused by fraud, criminal negligence or tortious wrong. Bankruptcy crime is a topic of

[191] Randal C. Picker and Michael W. McConnell, "*When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*", (*Supra*).

its own and discussion on the topic is outside the scope of this Thesis. However, with the NCP clearly overruling bailout for mismanagement of local council funds, which said mismanagement could be criminal, any insolvency law must be able not only to ensure the punishment of such fraud, criminal negligence or tortious wrong but also seeks means to deter their reoccurrence. Avoidance powers is a good way to retrieve fraudulent transfer, and the criminal prosecution under the ACA is another way to deal with criminal conduct in Sierra Leone.

## 5.2 Recommendation

It follows from the discussion that a form of municipal insolvency using the beneficial elements in Chapter 9 of the U.S.B.C. negation based debt adjustment will be useful in Sierra Leone. In coming forward with recommendations for municipal debt adjustment in Sierra Leone, this thesis has shown that other existing arrangements of enforcement against local councils, *ad-hoc* one-to-one arrangements and bailout could be complimented by a legal framework that encourages collective negotiations to reach a confirmed plan, which will be in the best interest of majority of the interested parties. The aim of reaching a balanced, fair and orderly outcome reduces the systemic risks and disincentive to extend credit to local government units.

Based on the foregoing, this thesis puts forward a recommendation for municipal insolvency law in Sierra Leone generally embodying the elements that have made the US based approached flexible and paradigmatic. The idea is to give the local councils a clean slate or 'fresh start' whenever they have gone through a successful debt adjustment, negotiated and confirmed by the court, without leaving a sour taste in the mouth of the creditors to the extent of increasing the cost local councils borrowing.

In considering the municipal insolvency legislation, two alternative routes could be taken: Firstly GoSL could make the corporate insolvency law (described in the second chapter of this

thesis) applicable to municipal insolvency. This will be incorporation by referencing, wherein municipal insolvency features on eligibility, capacity to further finance, limited role of the receiver, receiver-manager etc. (discussed in 5.1.1 of this thesis) will be added to the corporate insolvency law. This route would decrease any substantial opposition to the reform, and easy to accommodate. As discussed earlier, most of the elements in Chapter 9 of the U.S.B.C. could be found in the corporate insolvency law in Sierra Leone, although the law is liquidation oriented. What will be needed is a reorientation towards negotiation and discharge approach (rescue culture).

The second alternative route is to promulgate a municipal insolvency law that does not piggy back on the already existent corporate insolvency law, although the two will be connected. This may require more commitment and work from GoSL, but this separate legistion approach has already been taken by the government in having a separate and specific legislation for individual bankruptcy. Notwithstanding the approach taken, the municipal insolvency law must allow for creditors to be able to commence proceedings in addition to the eligibility criteria of the local councils already discussed. The eligibility test for insolvency must be pegged against failure to pay a certain specified amount, and the High Court must not be limited in exercising jurisdiction over municipal insolvency cases.[192]



[192] See 5.1.1 for discussion on the features.

## 6. Chapter Six: Conclusion

This thesis started with the objective to primarily examine the principles and elements of municipal insolvency through the lens of Chapter 9 of the U.S.B.C., and equally to assess the need and benefits of adopting such a system in Sierra Leone. Fundamental to the Chapter 9 (municipal debt adjustment) application is the negotiation based approach as discussed. The negotiation based approach employs certain unique features.[193] It follows therefore that this research answers the principal question of whether it is useful to embrace in Sierra Leone the negotiation-based approach, and if so, what concrete problems will it resolve.

The thesis concludes that the use of municipal insolvency, as practiced in the US, reduces the political and moral hazard associated with central government bailouts, the 'grab law' approach and further incentivize creditors for more lending at an economic rate. In other words, the lens of Chapter 9 of the U.S.B.C. has aided the illustration that a commercial viable negotiation based system bolsters the exiting practice of *ad hoc* arbitrary negotiations, unprotected race of the diligence and central government bailout. Thus, insolvency though undesirable is not necessary a bad thing. On the contrary, municipal insolvency based on a negotiable debt adjustment will provide a fair and orderly collective remedy whilst protecting the municipal debtor as well.



What this thesis has achieved is the initiation and conceptualization of a municipal insolvency outline in Sierra Leone, with recommendation for legislative action. The thesis recommends the adoption of municipal insolvency law in Sierra Leone, incorporating the pragmatic elements within the US negotiation based approach.[194] This is a logical conclusion to this research, which

[193] The features of eligibility, commencement, automatic stay, bankruptcy court limited powers, plan for debt adjustment, access to further credit, cramdown and confirmation of the plan have been discussed in chapter 4 of this thesis.
[194] See section 5.2 of this thesis – Recommendation.

commenced with a description of the present system of dealing with local councils' debt defaults in Sierra Leone. The present measures create an imbalance between the interest of the local councils and that of their creditors. The initial chapters of this thesis brought out the causes of the 2011 financial crisis of the Freetown City Council and how it was dealt with, that is, by criminal prosecution. The criminal prosecution did not wipe away the mounting debts of the City, if anything it led to a change in the management of the City. Without any further legislative action the status quo will continue.

By comparative methods, the principles and elements of the U.S. municipal bankruptcy system was described and analyze, bringing out the justification for its integral features. The scope of this thesis meant that in-depth analysis of case law could not be carried out. Whilst this research has met its objective, further research using case law analysis will be a useful addition to the general scholarship on municipal insolvency law. By reason of this research, we now know the benefits of municipal insolvency, and the justifications for the framing or use of its features. Further research on case law development will illustrate how those elements are put to practical use. On a final note, it must be stressed that the analysis of the key features of municipal bankruptcy in the US exhibited the suitability to export their underlying rationale in the development of a negotiation based municipal insolvency framework in Sierra Leone. This thesis has therefore laid a foundation for legislative action in Sierra Leone.

## 7. Bibliography

### Books


Adler Barry E and others, *Cases, Problems, and Materials on Bankruptcy.* (University casebook series, New York : Foundation Press Thomson/West, 2007).

Bork Reinhard and Schuller Christopher, *Rescuing Companies in England and Germany.* (Oxford : Oxford University Press, 2012).

Frey Martin A and Swinson Sidney K, *An Introduction to Bankruptcy Law.* (Clifton Park, NY : Delmar Cengage Learning, c2013).

Goode Royston Miles, *Principles of Corporate Insolvency Law.* (London : Sweet & Maxwell, 2011).

*Halsbury's Statutes of England and Wales.* (London : Butterworths, 1985).

*International Encyclopedia of Comparative Law.* (Tübingen : JCB Mohr (Paul Siebeck), [1973).

Jackson Thomas H, *The Logic and Limits of Bankruptcy Law.* (Washington, DC : Beard Books, 2001).

Keay Andrew R and Walton Peter, *Insolvency Law : Corporate and Personal.* (Bristol : Jordans, c2008).

Macassey NL, *Insolvency Law and Practice : Report of the Review Committee (the Cork Committee), (Cmnd. 8558) ; a Note* (Finance Houses Assoc 1982).

Tabb Charles Jordon and Brubaker Ralph, *Bankruptcy Law : Principles, Policies, and Practice.* (Cincinnati, Ohio : Anderson Publishing Co, c2003).

Shillington, Kevin. "Encyclopedia of African History." (2005).

Warren Charles, *Bankruptcy in United States History* (1972).

Watkins Dawn and Burton Mandy, *Research Methods in Law.* (Abingdon, Oxon: Routledge 2013 2013).

*Witness to Truth : Final Report of the Truth and Reconciliation Commission* (Human rights cases online (text), Accra, Ghana 2004).

Zweigert K, *International Encyclopedia of Comparative Law: Instalment 37* (Mohr 2003).


### Articles


Ashley Woods, "Detroit Bankruptcy Ruling By Judge Steven Rhodes Gives City Chapter 9 Protection", Huffington Post, [December 3, 2013], <http://www.huffingtonpost.com/2013/12/03/detroit-bankruptcy-decision-ruling-rhodes_n_4376775.html?utm_hp_ref=detroit-bankruptcy> accessed 11 March 2015.

Hempel George H, '*An Evaluation of Municipal "Bankruptcy" Laws and Procedures.*' (1973) 28 Journal of Finance 1339.

Lawall Francis J, *Debt Adjustments for Municipalities under Chapter 9 of the Bankruptcy Code.* (A Collier monograph, San Francisco : LexisNexis, 2012).

Lehmann Henry W, '*The Federal Municipal Bankruptcy Act*.' (1950) 5 Journal of Finance 241.

Levitin Adam J, '*In Defense of Bailouts, The [article]*' [2010] Georgetown Law Journal 435.

McConnell Michael W and Picker Randal C, 'When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy' [1993] The University of Chicago Law Review 425.

Sarat Austin, 'Special Issue - Interdisciplinary Legal Studies : The Next Generation (Studies in Law, Politics and Society Vol 51)' [2010].

Smart HM Joko, 'Place of Islamic Law within the Framework of the Sierra Leone Legal System, The [article]' [1980] African Law Studies 87.

Smith Christopher, 'Provisions for Access to Chapter 9 Bankruptcy: Their Flaws and the Inadequacy of Past Reforms [notes]' [1997] Bankruptcy Developments Journal 497.

Vivek Srivastava and Marco Larizza, "Decentralization in Postconflict Sierra Leone: The Genie Is Out of the Bottle", p.4-5, <http://siteresources.worldbank.org/AFRICAEXT/Resources/258643-1271798012256/YAC_chpt_8.pdf> accessed 2 March 2015.

V.V.B, "Detroit's bankruptcy plan, A phoenix emerges", (The Economist, 7 Nov. 2014) <http://www.economist.com/blogs/democracyinamerica/2014/11/detroits-bankruptcy-plan> accessed 11 March 2015.

'Avoiding and Using Chapter 9 in Times of Fiscal Stress.pdf'.

'Doing Business 2015 : Going beyond Efficiency - Sierra Leone (English) | The World Bank' (no date) <http://documents.worldbank.org/curated/en/2014/10/20357856/doing-business-2015-

'Executory Labor Contracts and Municipal Bankruptcy' [1976] (7) The Yale Law Journal 957.

Government of Sierra Leone, National Decentralization Policy, (Sept. 2010), pp.3 (unpublished).

'Hybrid Justice at the Special Court for Sierra Leone' [2010].



**Online Sources**

'Huffington Post, The' [2015] Britannica Online, http://www.huffingtonpost.com.

Law Information Institute, https://www.law.cornell.edu/.

Sierra Leone Legal Information Institute, www.sierralii.org.

Sierra Leone Web, http://www.sierra-leone.org/laws.html.

*The Economist.* (Winthertur, Switzerland : The Economist Newspaper Limited, 1843- 2015).

The United States Bankruptcy Court, East District of Michigan, http://www.mieb.uscourts.gov.

The United States Courts, http://www.uscourts.gov/FederalCourts/Bankruptcy.aspx.

The World Bank, http://documents.worldbank.org.

**Statutes**

England

The Enterprise Act 2002

The Joint Stock Companies Act 1844.

The Joint Stock Companies Winding-Up Act 1844.

The Insolvency Act 1989.

The Insolvency Amendment Acts of 1994 and 2000.

The "Statute of Bankrupts, 34 & 35 Hen. VIII, c4".

European Union

European Union Council Regulation on Insolvency Proceedings 2000, [(EC) No 1346/2000 of 29 May 2000].

Sierra Leone

The Anti-Corruption Act 2008.

The Bankruptcy Act No. 7 of 2009.

The Companies Act No.5 of 2009.

The Constitution of Sierra Leone Act No. 6 of 1991.

The Courts Act 1965.

The Freetown Municipality Ordinance of 1893.

The High Court Rules, Constitutional Instrument No. 25 of 2007.

The Local Courts Act 1963.

The Local Courts Act 2011.

The Local Government Act 2004.

The Public Debt Act No. 2 of 2011.

The State Proceedings Act No. 14 of 2000.

The Truth and Reconciliation Commission Act 2000.

United States of America

The Constitution of the United States of America.

The United States Bankruptcy Code

**Cases**

Sierra Leone

The State vs. Herbert A. George-Williams & Others [2012], High Court, unreported.

United States of America

Ashton v. Cameron Water Improvement District No. 1, 298 US 513 (1936).

Butner v. U.S., 440 U.S. 48 (1979).

Fowler v Padget (1798) 7 Term Rep 509; 101 ER 1103

In re City of Vallejo, 403 B.R. 72 (Bankr. E.D. Cal. 2009), aff'd, IBEW, Local 2376 v. City of Vallejo (In re City of Vallejo), 432 B.R. 262 (E.D. Cal. 2010).

In re City of Detroit, Michigan, Case No. 13-53846, [2015], "Order Approving Stipulation to Allow Claim No. 759 as a General Unsecured Claim in a Reduced Amount, (Entered: 03/02/2015)".

National Labor Relations Board vs. Bildisco & Baldisco 465 U.S. 513 (1984).

Orange Co. Employees Ass'n v. County of Orange (In re County of Orange) 179 B.R. 177 (Bankr. C.D. Cal. 1995);

United States v. Bekins et al, 304 U.S.27 (1983).