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## **CROSS-BORDER INSOLVENCY PROTOCOLS: FROM SOFT LAW TO INNOVATIVE RESTRUCTURING MECHANISMS?**

### **Summary**

*The insolvency of a multinational group presents a major challenge to cross-border creditor protection. Cross-border protocols have come to be used as privately negotiated instruments to coordinate concurrent insolvency proceedings in several jurisdictions. This paper studies several protocols and their private ordering potential for restructuring agreements. The US practice of recognising foreign restructuring plans is scrutinised. A section on restructuring mechanisms in the European Union, including the Schemes of Arrangements under the United Kingdom Companies Act 2006, concludes.*

**Key words:** *Cross-Border insolvency protocols, restructuring, schemes of arrangement.*

### **I Introduction**

#### **1. Freedom of Contract and Cross-Border Insolvencies**

The breakdown of the Lehman group has reinvigorated the debate on cross-border insolvencies of multinational conglomerates. In an effort to overcome difficulties creditors and insolvency administrators negotiated

two cross-border protocols, designed to harmonise concurrent insolvencies in several jurisdictions. The Lehman protocols are unprecedented for their ambition to privately regulate a global insolvency<sup>1</sup>. As a technique of private ordering they are not unprecedented, but their degree of sophistication is. They build on previous experiences in the Maxwell case<sup>2</sup> and on courts' willingness to save money and embark upon innovative mechanisms of restructuring within insolvency proceedings.

Multinational groups with centralised cash management systems present a textbook case for creditors' rights<sup>3</sup>. The efficient administration of the debtor's assets requires a cross-border approach towards restructuring and formal insolvency proceedings. Current practice emphasises comity. But national mandatory laws, private international law rules and the considerable diversity of creditor's rights pose the most important obstacles to truly universalist solutions. For practical purposes, private international law rules locate the main insolvency proceeding in the country where the debtor has his centre of main interests (COMI)<sup>4</sup>: Ancillary or secondary proceedings for foreign subsidiaries are generally accepted<sup>5</sup>. Representatives of the debtor's estate are normally entitled to appear in the ancillary proceedings and make apply for injunctions or a stay if the distribution of the debtor's assets will be prejudiced by creditor action. Nonetheless, serious problems of coordination for the equitable distribution of the debtor's international assets remain. At this stage, private ordering has stepped in order to coordinate court action and pave the way for a negotiated restructuring scheme, supplementing (and partially substituting) traditional court action in a trans-border insolvency case.

It has been one of the cornerstones of insolvency law that is mandatory and hence, not amenable to private ordering<sup>6</sup>. Nonetheless, United States (US), United Kingdom (UK) and other continental European insolvency laws

1 See *infra*, sub II.1.b.

2 See *infra*, sub II.1.a.

3 See generally I. Mevorach, "Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency", 18 *Cardozo J. Int'l. & Comp. L.* 359, 365 et seq. (2010) and I. Mevorach, *Insolvency within Multinational Enterprise Groups*, Oxford University Press, 2009, 151 et seq.

4 Art. 3 (1) of the Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, *O.J. L* 160/1 of 30 June 2000; see generally P. Wood, *Principals of International Insolvency*, 2<sup>nd</sup> ed., Sweet & Maxwell, 2007, § 30–021 et seq.

5 For an analysis of the US regulatory approach towards ancillary and parallel proceedings: J. L. Westbrook, "Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation", 76 *Am. Bankr. L. J.* 1, 10 et seq. (2002).

6 See S. Schwarcz, "Rethinking Freedom of Contract: A Bankruptcy Paradigm", 77 *Tex. L. Rev.* 515, 536 et seq. (1999).

have made major inroads into traditional legal doctrine by allowing privately negotiated restructuring settlements, to be approved by a court<sup>7</sup>. Although the European Insolvency Regulation does not explicitly envisage the cross-border protocols, this form of private ordering has also been accepted by English and French courts in an intra-European Union (EU) context<sup>8</sup>. Private ordering in a cross-border insolvency context pays heed to creditors' interests in various jurisdictions, thereby transcending the traditional notion of territoriality of bankruptcy (law). Ultimately, it forces national courts to decide on how much foreign private ordering they are willing to accept even if this forsakes established principles of creditor priority and secured transactions law.

## 2. The Issues

This paper will first review the US practise of cross-border insolvency protocols as an attempt to coordinate parallel insolvency proceedings in several jurisdictions. It will then enquire whether the protocols have a potential for extending private ordering to restructuring. US law on the recognition of foreign restructuring plans is assessed. The focus is then on negotiated restructuring mechanisms in the EU, particularly on the schemes of arrangement under the UK Companies Act and their application to non-UK companies. A section on the future for private contracting in the face of mandatory bankruptcy law concludes.

# II Cross-border Insolvency Protocols

## 1. Basics

Cross-border protocols are an attempt to overcome problems of concurrent insolvency proceedings in two jurisdictions or more, and to address problems of private international law. The protocols owe their existence to the particularities of US bankruptcy law and the challenges of globalisation. Chapter 11 of the US Bankruptcy Code fosters private initiative and consensus-building among creditors<sup>9</sup>. After a corporation has filed for protection under chapter 11, creditors are encouraged to negotiate a restructuring agreement which will have to be approved by a bankruptcy judge. Chapter 11 allows for 'pre-packaged' restructurings: Without formally filing for court protection a potential debtor may negotiate a mutually acceptable plan with

7 For a law and economics analysis: J. Armour, S. Deakin, "Norms in the Private Insolvency: The 'London Approach' to the Resolution of Financial Distress", 1 *JCLS* 21, 23 et seq. (2001).

8 See *infra* sub II.1.d.

9 S. Power Johnston, J. Han, 16 *J. Bankr. L. & Prac.* 5 Art. 7 (2007).

his major (financial) creditors. US courts have found no difficulty in exercising their discretion to approve pre-packaged reorganisation plans between a foreign debtor and their domestic and international creditors.

Cross-border protocols were first used to coordinate insolvency proceedings against debtors with assets in several jurisdictions<sup>10</sup>. Protocols focused on procedural issues and the rights of parties asserting claims against the debtor. Bankruptcy trustees entered into a multi-jurisdictional and cross-border insolvency protocol to accelerate the joint prosecution of claims and to engineer an exchange of confidential information<sup>11</sup>. If accepted by the courts, a cross-border protocol may operate to flesh standards of comity between two jurisdictions in order to avoid conflicting rulings and to establish joint consideration of legal issues<sup>12</sup>. More recently, cross-border protocols appear to be moving towards regulating substantive issues<sup>13</sup>. In a transatlantic reorganisation case, the protocol made an effort to harmonise management decisions by the US debtor (US bankruptcy law) and an English administrator (UK law). With the approval of the UK and US courts the English administrator assigned his power to oversee the UK subsidiaries to the US debtor management<sup>14</sup>. A cross-border insolvency protocol may also be concluded where a multinational corporation plans to restructure during concurrent bankruptcy proceedings by selling assets which have served as collateral under a loan agreement<sup>15</sup>.

Ideally, cooperation under a cross-border protocol produces a joint reorganisation plan. US courts and bankruptcy judges in other jurisdictions acknowledge this form of international cooperation which facilitates the restructuring of a debtor in accordance with creditors' interests, or in the case of distribution, the complete sale of the debtor's assets. In spite of their far-

10 A. V. Sexton, "Current Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: Comment – The Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation", 12 *Chi. J. Int'l. L.* 811, 821 et seq. (2012).

11 *In re Cercle Investors, Inc.*, 2008 WL 910062 (Bkrcty. S.D. Tex., 2008)

12 *In re Psinet, Inc.*, 268 B.R. 358, 364 FN 15 (Bkrcty. S.D.N.Y., 2001).

13 A. V. Sexton, 12 *Chi. J. Int'l. L.* 811, 822 (2012); J. Sarra, "Oversight and Financing of Cross-Border Business Enterprise Group Insolvency Proceedings", 44 *Tex. Int'l. L. J.* 547, 566 et seq. (2009) (on substantive coordination). See generally J. L. Westbrook, "Choice of Avoidance Law in Global Insolvencies", 17 *Brook. J. Int'l. L.* 499, 510 et seq. (1991).

14 *In re Federal-Mogul Inc.*, 2007 WL 4180545 (Bkrcty. D. Del., 2007). See also the US-Canadian case where a protocol coordinated cross-border management decisions necessary to implement a reorganisation plan: *In re Olympia & York Developments*, 1996 WL 1786249 (Ont. Gen. Div. (C.L.), 1996), and Examiner's Governance Protocol, available at <http://www.iiiglobal.org/component/jdownloads/finish/395/1524.html>.

15 See *Rendall v. Commissioner of Internal Revenue*, 535 F.3d 1221, 1223 et seq. (3<sup>rd</sup> Cir., 2008).

reaching effects, cross-border protocols are still regarded as a body of soft law<sup>16</sup>. This is due to uncertainties about the freedom of contract in the context of private international bankruptcy law and national banking laws. As soon as the mandatory character of mandatory national bankruptcy rules is challenged, the debate of creditors' rights and their priority under secured transactions law will reignite<sup>17</sup>. Moreover, it is far from clear how the current interface between mandatory laws and privately negotiated cross-border protocols will affect creditors' preferences for cooperative or uncooperative behaviour during reorganisation negotiations. A purely domestic negotiation game under chapter 11 proceedings is designed to produce creditor coalitions in favour of a reorganisation plan<sup>18</sup>. This does not imply that creditors will behave cooperatively during the negotiations<sup>19</sup>. Conversely, concurrent cross-border insolvencies of a complex conglomerate with a centralised cash management system are likely to trigger cooperative behaviour in order to collect the debtor's assets spread over several jurisdictions<sup>20</sup>. Ultimately, creditor behaviour will be predicated on the enforceability of an international reorganisation plan and the willingness of courts to honour comity obligations in spite of severe public policy concerns.

#### a) *Maxwell*

The death of Robert Maxwell in 1991 triggered scandal, criminal investigations and concurrent insolvency proceedings in the US and the UK<sup>21</sup>. Maxwell controlled an English holding company which, in turn, two US subsidiaries which constituted almost 80 percent of the Maxwell group<sup>22</sup>. In or-

16 See generally T. C. Halliday, "Legitimacy, Technology, and Leverage: The Building Blocks of Insolvency Architecture in the Decade Past and the Decade Ahead", 32 *Brook. J. Intl. L.* 1081, 1091 et seq. (2007).

17 Cf. E. Warren, J. L. Westbrook, "Contracting out of Bankruptcy: An Empirical Intervention", 118 *Harv. L. Rev.* 1197, 1204 et seq. (2005); J. L. Westbrook, 17 *Brook. J. Intl. L.* 499, 512 et seq. (1991).

18 Cf. D. Baird, R. K. Rasmussen, "Antibankruptcy", 119 *Yale L. J.* 648, 687 et seq. (2010); J. I Werbalowsky, "Reforming Chapter 11: Building an International Restructuring Model", 8 *J. Bankr. L. & Prac.* 561, 573 et seq. (1999).

19 A. Annabi, M. Breton, P. François, "Resolution of Distress under Chapter 11" (December 2010), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1723359](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1723359).

20 See the analysis of Lehman's trans-border cash management system in re Lehman Brothers Holdings, Inc., 404 B.R. 752, 760 et seq. (Bkrcty. S.D.N.Y., 2009).

21 See J. Pottow in: R. K. Rasmussen (ed.), *Bankruptcy Law Stories*, Foundation Press, 2007, 221, 230 et seq.; P. H. Zumbro, "Cross-Border Insolvencies and International Protocols – An Imperfect But Effective Tool", 11(2) *Bus. L. Intl.* 157, 163 et seq. (2010).

22 In re Maxwell Communication Corp., plc, 170 B.R. 800, 802 et seq. (Bkrcty. S.D.N.Y., 1994).

der to avert dismemberment by its creditors, the group filed for protection under chapter 11 of the US Bankruptcy Code with a US court while at the same time applying for administration under the UK Insolvency Act of 1986 in the English High Court of Justice. The US court appointed an examiner to harmonise the two proceedings who should ultimately prepare a reorganisation under US law with a view to maximise return to the creditors<sup>23</sup>. After signing a protocol the English joint administrators and the US examiner cooperated to manage the Maxwell and to prepare US reorganisation plan and a UK scheme of arrangement which, mutually dependent, set up a single 'pot' for distributions to all creditors<sup>24</sup>. Moreover, under the terms of the single distribution mechanism, creditors were entitled to file a claim in either jurisdiction to participate under the reorganisation plan and the scheme of arrangement<sup>25</sup>.

The Protocol between the Examiner and the Joint Administrators provides for joint corporate governance mechanisms to ensure that the corporations of the Maxwell be administered in accordance of applicable corporation laws to protect creditor interests. The Examiner and the Joint Administrators pledge to cooperate in preparing the reorganisation plan and the scheme of arrangement. The protocol explains at considerable length where each side may act without seeking prior consent of the other, and where the approval of the US Bankruptcy Court or the English High Court has to be sought<sup>26</sup>.

### *b) Lehman Brothers*

Lehman Brothers was the fourth largest bank in the United States with more than 650 entities or subsidiaries in foreign jurisdictions<sup>27</sup>. In September 2008 it filed for protection under chapter 11 of the United States Bankruptcy Code, triggering one of more than 27 separate proceedings with 16 administrators operating in nine different jurisdictions<sup>28</sup>. In recognition of Lehman's cash centralized cash management and information exchange systems interested creditor acutely felt the need to coordinate bankruptcy proceedings in order to introduce effective case management and consistency of judgments

23 S. Power Johnston, J. Han, 16 *J. Bankr. L. & Prac.* 5 Art. 7 (2007).

24 *In re Maxwell Communication Corp., plc.*, 170 B.R. 800, 802 et seq. (Bkrcty. S.D.N.Y., 1994); *In re Maxwell Communication Corp., plc.*, 93 F. 3d 1036, 1041 et seq. (2<sup>nd</sup> Cir., 1996).

25 *In re Maxwell Communication Corp., plc.*, 170 B.R. 800, 802 (Bkrcty. S.D.N.Y., 1994); *In re Maxwell Communication Corp., plc.*, 93 F. 3d 1036, 1042 (2<sup>nd</sup> Cir., 1996).

26 Protocol between the Examiner and the Joint Administrators of 12 January 1992, available at <http://www.iiiglobal.org/component/jdownloads/finish/395/1523.html>.

27 J. Altman, 12 *San Diego Int'l. L. J.* 463, 464 et seq. (2011).

28 *Ibid.*

to be eventually rendered. The factual setting of the Lehman Protocol differs considerably from the Maxwell scenario. Due to the sheer magnitude of the proceedings cooperation in a spirit of comity between the courts was more difficult to achieve. Moreover, the complexity of Lehman's required two insolvency protocols. The 'regular' cross-border insolvency protocol<sup>29</sup> had to be supplemented by a specific agreement on how to handle problems arising out of the credit default swaps (CDS's) had formed a crucial element of Lehman's financing techniques. UK creditors declined to sign the Lehman cross-border insolvency protocol. The International Swaps and Derivatives Association initiated a CDS Protocol which was to engineer a wash-out between the parties and counterparties<sup>30</sup>. Subsequent litigation in the US and the UK demonstrated that the soft law of cross-border protocols was ill-equipped to address difference in substantive secured transactions laws which would translate into discriminatory treatment between creditors<sup>31</sup>.

The Lehman cross-border insolvency protocol pledges to maximise the recoveries for all creditors while acknowledging the diversity of bankruptcy laws across the various jurisdictions. Consequently, the protocol does not attempt to impose duties on the participating administrators, nor does create legally enforceable duties. The major thrust of the protocol is to facilitate co-ordination of the various national insolvency proceedings, communication and data sharing between the creditors' official representatives. In spite of its largely non-binding nature there is however a stipulation which heeds to the conglomerate structure of the Lehman group: The signatories to the protocol are to introduce claims reconciliation mechanism in order to provide "for a consistent and measured approach to the calculation and adjudication of intercompany claims that avoids unnecessary intercompany litigation". The protocol confers the right on each signatory to appear in court proceedings in another jurisdiction, although such appearance shall not be deemed to constitute acknowledgment of a foreign jurisdiction. The protocol does not make an effort to flesh out specific rules for the communication between the numerous courts involved in the Lehman group bankruptcy. Instead, it incorporates the 'Guidelines Applicable to Court-to-Court Communications

29 Cross-border Insolvency Protocol for the Lehman Brothers Group of Companies of 12 May 2009, available at <http://www.globeturnaround.com/cases/Lehman%20Protocol.pdf>, and Order Approving the Proposed Protocol, In re Lehman Brothers Holdings, Inc., (Bkrtcy, S.D.N.Y., 2009).

30 ISDA 2008 Lehman CDS Protocol of 6 October 2008, available at <http://www.isda.org/2008lehmancdsprot/docs/Lehman-CDS-Protocol.pdf>.

31 See In re Lehman Brothers Holdings, Inc. v. BNY Corporate Trustee Services Ltd., 422 B.R. 407 (Bkrtcy. S.D.N.Y., 2010); Perpetual Trustee Co. Ltd. v. BNY Corporate Trustee Services Ltd., [2009] EWHC 2953 (Ch.), see Stratton, Custer, "Shot Heard Around the CDO World: Flip Clauses Found to Be Unenforceable Ipso Facto Provisions", 29 *Am. Bankr. Inst. J.* 30, 66 (April 2010).

in Cross-Border Cases' promulgated by the American Law Institute in association with the International Insolvency Institute<sup>32</sup>. Close reading of the protocol suggests that courts cannot be bound by this stipulation. But the 'Guidelines' might be understood as an exhortation to persuade a court that they embody an update of comity in trans-border insolvency cases<sup>33</sup>. Asset protection for the benefit of the creditors is to be realized by a specific notification mechanism. If an official representative learns in his jurisdiction that another debtor may have a material interest in the assets he shall cooperate to maximize the debtor's interest in the property.

The Lehman protocol attempts to impose more far-reaching obligations with respect to intercompany claims. A committee is established to introduce binding accounting procedures for the valuation of these claims. It is on the basis of these valuation standards that the creditors' representatives for Lehman subsidiaries shall enter into negotiations to settle intercompany claims by consensual mechanisms. Unless an error is established an intercompany claim shall be treated *prima facie* as valid. The authority of the creditors' committee shall extend to intercompany derivative contracts. With respect to these derivative contracts the committee is entrusted with ascertaining a methodology to establish the value for contracts which have been rejected, terminated, liquidated or accelerated by a debtor's counterparty.

The Lehman protocol pays homage to the Maxwell protocol by urging creditors to coordinate their national winding-up plans or schemes for reorganisation or liquidation to the effect that each plan is economically dependent on the other. Nonetheless, these obligations are considerably less binding than under the cooperative setting of the Maxwell bankruptcy. Creditor representatives or administrators are under no duty to agree to a plan proposed for another jurisdiction. Any consent given may not be construed as a waiver to raise objections to the plan of another official representative.

### c) *Madoff*

Bernard Madoff had founded a US limited liability company of he was the sole member<sup>34</sup>. This limited liability company engaged in market making, proprietary and investment advisory services. It had a UK subsidiary, Madoff Securities International Ltd. which supported the activities of its US parent.

32 Of 16 May 2000/10 June 2001, available at <http://www.ali.org/doc/Guidelines.pdf>.

33 See on the judicial adoption of the ALI/III Guidelines: B. Leonard, "The Development of Court-to-Court Communications in Cross-Border Cases", 17 *Norton J. Bankr. L. & Pract.* 5 Art. 2 (2008).

34 For a comprehensive report see In re Bernard Madoff, Trustee's Amended Third Interim Report for the Period Ending 31 March 2010, available at <http://www.madoff.com/document/reports/000002-thirdinterimreport.pdf> (Bkrcty. S.D.N.Y., 2010).

In 2008, Madoff was arrested for having practised a securities fraud (Ponzi) scheme. At the request of certain creditors of Madoff, the US parent company was forced into involuntary bankruptcy and a receiver was appointed for the UK assets<sup>35</sup>. Upon the application by the directors of the UK subsidiary the English High Court of Justice was placed the company into provisional liquidation<sup>36</sup>. In order to facilitate the liquidation of the US and UK companies for the benefit of the creditors, the US trustee for the liquidation of Madoff's UK branch and the joint provisional liquidators for the UK company entered into protocols which were approved by the respective court<sup>37</sup>. The Cross-Border Protocol provides for cooperation and information-sharing in order to identify, preserve and realise assets for the fair distribution among the creditors of all classes of creditors. The protocol confers a right on each representative of the respective companies in liquidation to appear in proceedings and to share confidential and privileged information. The Cross-Border protocol incorporates by reference the 'Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases'<sup>38</sup>, envisaging that the competent bankruptcy tribunals will eventually adopt them. Finally each representative undertakes to cooperate in identifying, preserving and realising assets that the other representative may have an interest in<sup>39</sup>. The Information Protocol sets forth which information will have to be disclosed to the other party, and lays down ground rules for maintaining confidential information. The costs for searching and sharing information will be borne by both parties<sup>40</sup>. In October 2011 the Trustee for the US company began to distribute assets to the creditors while he continued litigation against third parties who allegedly had benefited from the Madoff fraud scheme<sup>41</sup>.

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35 *Ibid.*

36 See Order pursuant to Sections 1526, 1527 and 105(a) of the Bankruptcy Code Approving Protocols by and between the Trustee and the Joint Provisional Liquidators of Madoff Securities International Limited, Securities Investor Protection v. Bernard Madoff Investment Securities, LLC., available at <http://www.iiiglobal.org/component/jdownloads/finish/395/3676.html> (Bkrcty. S.D.N.Y., 2009).

37 *Ibid.*

38 Developed by the American Law Institute and the International Insolvency Law Institute, fleshing out the UNCITRAL Model Law on Cross-Border Insolvency (2000/2001), available at <http://www.iiiglobal.org/component/jdownloads/finish/394/1506.html>.

39 *Ibid.*

40 *Ibid.*

41 Bloomberg News, 4 October 2011, "Madoff Trustee to Begin Distributions Tomorrow", available at <http://www.bloomberg.com/news/2011-10-04/madoff-trustee-says-victim-distributions-of-312-million-to-start-tomorrow.html>.

*d) Sendo International Limited*

Under the European Insolvency Regulation bankruptcy proceedings shall be opened in the Member State where the debtor has his centre of main interests<sup>42</sup>. If a debtor corporation has a subsidiary in another Member State, a secondary proceeding may be brought in that jurisdiction<sup>43</sup>. Although the European Insolvency Regulation strives for clarity from a private international law perspective, it does not provide for comprehensive rules for concurrent bankruptcies in a trans-border setting<sup>44</sup>. Art. 32 of the Regulation empowers creditor to lodge their claims in the main proceeding and in any secondary proceeding. Art. 31 lays down rather broad duties of communication between the liquidators in the main and secondary proceedings, but does not specify how the interests of the creditors might be best served in a European cross-border context. The Sendo 'Protocol Agreement for the Coordination of a Main Insolvency Proceeding with a Secondary Insolvency Proceeding' of June 2006 appears to be the first cross-border protocol under the European Insolvency Regulation<sup>45</sup>.

Sendo International Ltd. was established under the laws of the Cayman Islands and registered as a foreign company in the United Kingdom. Sendo had a French main office at the time the English High Court of Justice appointed joint administrators for Sendo's English insolvency proceedings. The joint administrators requested the opening of a secondary insolvency proceeding in France and the Commercial Court of Nanterre appointed in accordance with French law a (French) liquidator. The English joint administrators and the French liquidator signed a cross-border protocol acknowledging the necessity to coordinate activities with respect to the liabilities and assets of the French branch of Sendo. The stipulations of the protocol provide for procedures to notify the international creditors of Sendo. In view of art. 32 of the European Insolvency Regulation the protocol dispenses the joint administrators of informing their French counterparts since the assets of the French branch were so poor that any distribution to creditors was unrealistic. Nonetheless, the parties to the protocol agree on mechanisms for verifying corporate liabilities. Although each party shall verify claims in accordance with applicable national laws, mutual information duties are established. The parties pledge to entertain a dual verification of claims and introduce proceedings for the disposal of the assets, including their prospective transfer for distribution to the international creditors.

42 Art. 3(1) of the European Insolvency Regulation.

43 Art. 27 of the European Insolvency Regulation.

44 See M. M. Winkler, "From Whipped Cream to Multibillion Euro Financial Collapse: The European Regulation on Transnational Insolvency in Action", 26 *Berkeley J. Int'l. L.* 352, 357 et seq. (2008).

45 Available at <http://www.iiiglobal.org/component/jdownloads/finish/395/1734.html>.

## 2. A Brighter Future?

Cross-border protocols are clearly the product of ad-hoc contractualism<sup>46</sup>. They are encouraged as an attempt to resolve issues of international bankruptcy law by private ordering<sup>47</sup>. Protocols may also be used to introduce a standstill period where creditor banks assess whether there is a likelihood that the debtor corporation survives after a restructuring and the injection of fresh money<sup>48</sup>. Cross-border protocols will become ‘self-enforcing’ if it is in the parties’ interest to adhere to a scheme of cooperative duties. Creditors will not play the cooperative game of signing a protocol if there is a chance that the liquidation of local entities of a multi-national corporation is more profitable than a global approach towards multiple domestic creditors’ claims<sup>49</sup>. On the other hand, the liquidation or sale of an insolvent enterprise (group) as a going concern may be sufficient to create cooperative behaviour<sup>50</sup>.

The Lehman protocols give ample evidence of the complexity of devising a cross-border protocol for heavily integrated financial conglomerates where national laws on secured transaction frustrate an overly comprehensive approach. Nonetheless, cross-border protocols have a potential for more substantive private ordering if private international law rules would liberally accept private contracting in trans-national insolvency cases, including negotiated distribution schemes in spite of mandatory priority rules under secured transaction law. US managers have expressed a preference for restructurings and work-outs as an exercise which cuts the transactions costs of a formal bankruptcy proceeding. Conversely, they acknowledge that negotiations in the shadow of a pending bankruptcy proceeding afford them greater bargaining power with respect to recalcitrant creditors<sup>51</sup>. Current recognition practice of cross-border reorganisation plans will shed some light on the obstacles the proponents of privately negotiated insolvency solutions have to overcome.

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46 I. Mevorach, 18 *Cardozo J. Int'l. & Comp. L.* 359, 385 (2010).

47 *Ibid.*

48 Cf. INSOL International, Statement of Principles for A Global Approach to Multi-Creditor Workouts (2000), available at <http://www.insol.org/pdf/Lenders.pdf>.

49 J. Sarra, 44 *Tex. Int'l. L. J.* 547, 550 et seq. (2009).

50 J. Sarra, 44 *Tex. Int'l. L. J.* 547, 551 (2009).

51 M. J. White, “Corporate Bankruptcy as Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings”, 10 *J. L. Econ. & Org.* 268, 287 et seq. (1994), from a German Perspective: P. Jostarndt, Z. Sautner, “Out-of-Court Restructuring versus Formal Bankruptcy in a Non-Interventionist Bankruptcy Setting” (August 2009), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1107115](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1107115), discussing debt restructurings.

### III Restructuring a Multinational Corporation

#### 1. The UNCITRAL Legislative Guide on Insolvency Law

According to the 2005 UNCITRAL 'Legislative Guide on Insolvency Law' a reorganisation does not necessarily require judicial intervention to approve the plan<sup>52</sup>. But there are key elements necessary to ensure its success: automatic or mandatory stay of actions and proceedings against the debtor, continuation of the business, formulation of a plan addressing the future of creditors' rights, equity holders and the debtor and creditors' vote on the acceptance of the plan. The 'Legislative Guide' acknowledges that complex arrangements are likely to thwart a voluntary agreement, hence the need to introduce a greater degree of formality. Formal insolvency proceedings may be apposite to engineer a reorganisation plan which can be imposed on the dissenting minority of creditors<sup>53</sup>. The UNCITRAL guidelines favour expedited reorganisation proceedings as an alternative to insolvency proceedings, which should only be triggered when the negotiations for an expedited reorganisation break down<sup>54</sup>. The UNCITRAL 'Legislative Guide' admits that cross-border restructurings tend to magnify the intricacy of negotiations as creditor consent will be difficult to obtain<sup>55</sup>. The 'Guide' makes a reference to principles published by the INSOL, a private association of international insolvency accountants and lawyers. This reference might be understood as an invitation to scrutinise the dynamics of negotiating an international reorganisation plan. But it could also be read as a message of resignation in the face of complex private international law problems.

##### *a) United States Law on Recognition of Foreign Restructuring Plans*

The US Bankruptcy Code has enacted the UNCITRAL Model on Cross-Border Insolvency<sup>56</sup> requiring US courts to recognise foreign proceedings<sup>57</sup>.

52 Sec. 28 of the UNCITRAL (United Nations Commission on International Trade Law), *Legislative Guide on Insolvency Law*, New York 2005, available at [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf); see also J. Armour, S. Deakin, 1 *JCLS* 21, 34 et seq. (2001), evaluating the 'London approach' towards the resolution of financial distress.

53 In this context, a bankruptcy scheme will trade-off the initial priority of claims with the viability of reorganized firms: A. Annabi, M. Breton, P. François, "Game theoretic analysis of negotiations under bankruptcy" (May 2011), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1856255](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1856255).

54 See sec. 76 et seq. of the Legislative Guide.

55 *Ibid.*, at sec. 77.

56 United Nations Commission on International Trade Law (UNCITRAL), *UNCITRAL Model Law on Cross-Border Insolvency* (1997), available at <http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf>.

57 See 11 §§ 1506 et seq., §§ 1532 et seq. USC; In re Ionica Plc, 241 B.R. 829 (835) (Bkcty. S.D.N.Y., 1999), and In re Artimm, 335 B.R. 149 (161 et seq.) (Bkrtcy. C.D. Cal., 2005),

US law will disregard comity and the universality of bankruptcy proceedings only if the recognition of a foreign proceeding would be manifestly contrary to the policy of the United States<sup>58</sup>. A foreign bankruptcy proceeding will not be recognised if an orderly, efficient and equitable distribution of the debtor's assets is unlikely<sup>59</sup>. US law does not prevent a creditor from filing a claim in more than one of the insolvency proceedings against a multinational debtor, but although the claim is not netted out, no creditor will receive a distribution of more than 100 percent of the claim<sup>60</sup>. Experience under the Maxell and Lehman cases illustrate that courts of two countries will cooperate in order to avoid distributions which disregard parity principles and the notion of '*pari passu*'.

Ancillary proceedings in the US may only be brought if the debtor has domestic assets<sup>61</sup>. Otherwise the rule of *res judicata* would prevail<sup>62</sup>. However, comity will not overcome conflicting policy choices by national regulators<sup>63</sup>. The Parmalat securities litigation in the US presents an intriguing example of how US courts are prepared to integrate a foreign reorganisation plan into domestic law. The Parmalat group was an Italian family-owned business which had collapsed after a complex fraud scheme had been discovered<sup>64</sup>. The Parmalat group filed for bankruptcy in Italy and the majority of creditors approved a reorganisation scheme (a '*concordato*')<sup>65</sup>. Under the terms of

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and Lifland, Chapter 15 of the United States Bankruptcy Code: An Annotated Section-by-Section Analysis, in: Affaki (ed.), *Faillite internationale et conflit de jurisdiction – Regards croisés transatlantiques – Cross border insolvency and conflict of jurisdictions – A US-EU experience* (2007), at p. 31 et seq.

58 11 § 1506 USC.

59 Reserve International Liquidity Fund, Ltd. v. Caxton International Limited, 2010 WL 1779282 (S.D.N.Y., 2010).

60 See L. DeCarl Adler, *Managing the Chapter Cross-Border Insolvency Case – A Pocket Guide for Judges* (Federal Judicial Center 2011), 25 et seq., available at [http://www.fjc.gov/public/pdf.nsf/lookup/adlerchap15.pdf/\\$file/adlerchap15.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/adlerchap15.pdf/$file/adlerchap15.pdf).

61 11 § 1528 USC. See generally A. Ranney-Marinelli, "Overview of Chapter 15 Ancillary and Other Cross-Border Cases," 82 *Am. Bankr. L. J.* 269 (2008).

62 Cf. *In re Parmalat Securities Litigation*, 493 FS 2d 723 (732 et seq.) (S.D.N.Y., 2007).

63 See B. C. Matthews, "Emerging Public International Banking Law? – Lessons from the Law of the Sea Experience", 10 *Chi. J. Int'l. L.* 539, 559 et seq. (2010), and the statement per Chief Judge Re in: *Cunard S.S. Co. Ltd. v. Salen Reefer Services AB*, 773 F. 2d 452 (457) (2<sup>nd</sup> Cir., 1985):

"...Comity will be granted to the decision or judgment of a foreign court if it is shown that the foreign court is a court of competent jurisdiction, and that the laws and public policy of the forum state and the rights of its residents will not be violated..."

64 *In re Parmalat Securities Litigation*, 493 FS 2d 723, 725 et seq. (S.D.N.Y., 2007); see account in M. M. Winkler, 26 *Berkeley J. Int'l. L.* 352, 357 et seq. (2008).

65 See Brief of Appellees in *re Parmalat Securities Litigation*, 2007 WL 6196826 (2<sup>nd</sup> Cir., 2007).

the 'concordato' a new Parmalat company was formed to collect some of the foreign assets of 'old' Parmalat and to handle claims by unsecured creditors. Investors in the US claimed that the new Parmalat company was the successor of the old one and was thus the appropriate defendant for a class action for securities fraud committed by the old Parmalat group. The investors contended they had standing to sue since the Italian 'concordato' did not cover the claims they were raising. The representative of the old Parmalat's estate moved for an injunction. The US district rejected the motion for an injunction, holding that *res judicata* did not apply. Issues of fraud had not been the subject of the negotiations of the 'concordato' and comity was not violated, since any contribution judgment would ultimately be in the competence of the Italian courts<sup>66</sup>. The debtor representative appealed and the US Court of Appeals for the Second Circuit confirmed. In a majority holding, the Court explained comity towards the Italian court and its 'Concordato' would be sufficiently observed since any favourable judgment obtained in the US could not be enforced against the debtor's asset without the cooperation of Italian judges<sup>67</sup>.

A 2001 judgment of the US Court of Appeals for the Second Circuit has been criticised for narrowing down the concept of international comity. Ruling on an action to turn over domestic assets subject to a security interest in the US, the court appears to question the balance between creditor and debtor interest determined in a non-domestic proceeding<sup>68</sup>. The Court acknowledges that priority rules are not universal, but rejects recognition of foreign bankruptcy proceedings because non-domestic rules on the treatment of administrative expenses would substantially disadvantage secured creditors in the US<sup>69</sup>. Subsequent cases have attempted to narrow down the scope of the second circuit holding: Comity does not require that a foreign bankruptcy law provides for an identical treatment of a claim. There is no breach of US public policy as long as the foreign bankruptcy law affords sufficient procedural safeguards<sup>70</sup>. Comity should facilitate an orderly and fair distribution of the debtor's assets collected world-wide<sup>71</sup>.

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66 In re Parmalat Securities Litigation, 493 F.S.2d 723, 738 et seq. (S.D.N.Y., 2007).

67 Bondi v. Capital & Finance Asset Management S.A., 535 F.3d 87, 92 et seq. (2<sup>nd</sup> Cir., 2008).

68 See the criticism by P. L. Lee, "Ancillary Proceedings Under Section 304 and Proposed Chapter 15 of the Bankruptcy Code", 76 *Am. Bankr. L. J.* 115, 125 et seq. (2002).

69 In re Treco, 240 F.3d 148, 156 et seq. (2<sup>nd</sup> Cir., 2001)

70 In re Petition of the Board of Directors of Compañía General de Combustibles SA et al., 269 B.R. 104, 111 et seq. (2001); In re Petition of the Board of Hopewell International Insurance, 281 B.R. 200, 214 et seq. (Bkrcty. S.D.N.Y., 2002).

71 In re Rosametta, S.R.L., 336 B.R. 557, 564 et seq. (Bkrcty. S.D. Fla., 2005).

*b) Restructuring Mechanisms in the European Union and Schemes of Arrangement*

In handling cross-border cases, courts in the EU's Member States have to observe the delicate balance between autonomous private international law rules and the European Insolvency Regulation. Traditional private international law rules apply with respect to third countries. Under the European Insolvency Regulation, the debtor's centre of the main interests controls both the forum and the applicable law. Secondary proceedings may only be brought if the debtor has an establishment in another member state. A (preliminary) insolvency administrator of the main proceeding may file an application for commencing a secondary proceeding in another member state<sup>72</sup>.

Regrettably, the European Insolvency Regulation does not offer much guidance for choice of law and recognition problems of cross-border protocols in a European context. Art. 1(2) of the Regulation exempts insolvency proceedings concerning insurance undertakings, credits institutions, investment undertakings administering funds or securities for third parties, and to collective undertakings. An annex to art. 2(a) specifies which national insolvency proceedings are covered by the Regulation<sup>73</sup>. The Regulation also applies to Germany's recent amendments to her *Insolvenzordnung*<sup>74</sup> (Insolvency Regulation). But it is as yet unclear to what extent Germany's new restructuring law will add substantially to private contracting in the vicinity of or during insolvency proceedings<sup>75</sup>. French and Luxembourg laws provide pre-packaged schemes which cram down minority creditors<sup>76</sup>, or compositions without formally opening bankruptcy proceedings<sup>77</sup>, but they are not listed

72 R. Dammann, F. Müller, "Eröffnung eines Sekundärverfahrens in Frankreich gem. Art. 29 lit. a EuInsVO auf Antrag eines 'schwachen' deutschen Insolvenzverwalters", 2011 (19) *Neue Zeitschrift für Insolvenzrecht* 752 et seq.

73 See generally P. Nabet, *La Coordination des Procédures d'Insolvabilité en Droit de la Faillite Internationale et Communautaire* (Paris 2010), at p. 45 et seq.

74 See H. Vallender, "Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen [ESUG] – Das reformierte Plan- und Eigenverwaltungsverfahren", 60 *Monatsschrift für Deutsches Recht* 125 et seq. (2012).

75 Cf. P. Mankowski, "Anerkennung englischer Solvent Schemes of Arrangements in Deutschland", 65 *Wertpapier-Mitteilungen* 1201, 1209 (2011).

76 See for France: H. Crozé, "Loi de sauvegarde – Panorama général et procédural", 2005 (10) *Procédures*, étude 11; A. Besse, N. Morelli, "Le prepackaged plan à la française: –pour une saine utilisation de la procédure de sauvegarde", *La Semaine Juridique Entreprise et Affaires* No. 25, 18 juin 2009, 1628 et seq.; G. Berthelot, "Le droit des procédures collectives à nouveau réformé: "De la Sauvegarde financière accélérée", *Actualité des procédures civiles et commerciales*, No. 17, 29 octobre 2010, p. 1 et seq.

77 See for Luxembourg: Allen & Overy, *Restructuring Across Borders – Luxembourg: corporate restructuring and insolvency procedures* (September 2011).

in the annex<sup>78</sup>. Nor are the English schemes of arrangement under sec. 895 et seq. of the Companies Act of 2006.

English schemes of arrangement have gained notoriety in cross-border restructurings as they appear to unleash regulatory competition in insolvency law<sup>79</sup>. Companies from other EU member states consider these schemes as a vehicle for transcending the limitations of their own domestic insolvency laws. Contrary to COMI requirements under the European Insolvency Regulation, companies which plan to restructure under English law do not have to relocate to the UK in order to negotiate a scheme of arrangement: The English High Court accepted jurisdiction when 56% of the creditors were located in the UK<sup>80</sup>. German and Spanish companies appear to be the European pioneers in having their schemes approved by an English court<sup>81</sup>.

Pursuant to sec. 895 of the UK Companies Act of 2006, a scheme of arrangement is a compromise or arrangement between a company and its creditors, or any class of them, or its members or any class of them. A scheme introduces a global commutation (including reconstruction and amalgamation) requiring both approval of a court and at least 75% of the creditors<sup>82</sup>. Upon application by a creditor, the company or any member of the company, the court will order a meeting<sup>83</sup>. Every notice summoning the meeting has to be accompanied by a statement explaining the effect of the compromise or arrangement<sup>84</sup>. If creditor approval is obtained, the court will sanction a compromise or a scheme of agreement which is binding upon all creditors or the class of creditors or on the members or class of members once it has been delivered to registrar<sup>85</sup>. Most scheme provide for a deadline for filing claims.

78 For a survey of of restructuring mechanisms in the member states of the European Union see the country reports in Getting the Deal Through (eds.), *Restructuring and Insolvency in 57 jurisdictions worldwide* (2009).

79 See generally on regulatory competition in insolvency law among EU member states: G. Hölzle, "Die Sanierung von Unternehmen im Spiegel des Wettbewerbs der Rechtsordnungen in Europa", 72 *KTS – Zeitschrift für Insolvenzrecht* 290 et seq. (2011), and H. Eidenmüller, Tilmann Frobenius, "Die international Reichweite eines englischen Scheme of Arrangement", 65 *Wertpapier-Mitteilungen* 1210, 1218 (2011).

80 In the Matter of Rodenstock, [2011] EWHC 1104 (Ch).

81 L. Westphal, M. Knapp, "Die Sanierung deutscher Gesellschaften über ein englisches Scheme of Arrangement", 32 *Zeitschrift für Wirtschaftsrecht* 2033 et seq. (2011); *Re La Seda De Barcelona*, [2010] EWHC 1364 (Ch); *Trimast Holding Sarl v. Tele Columbus GmbH*, [2010] EWHC 1944 (Ch); In the Matter of Rodenstock, [2011] EWHC 1104 (Ch).

82 See §§ 895, 899 (1) of the Companies Act 2006; Financial Services Authority (FSA), *FSA process guide to decision making on Schemes of Arrangement for insurance companies* (July 2007).

83 § 896 Companies Act 2006.

84 § 897 (1) Companies Act 2006.

85 § 899 (3), (4) Companies Act 2006.

Creditors who do not observe this deadline for filing claims will not be considered for distribution under the scheme<sup>86</sup>.

Schemes of arrangement have received a mixed welcome by German courts. In applying private international law rules of the German *Insolvenzordnung* a district court (*Landgericht*)<sup>87</sup> analogised the proceedings for a scheme of arrangement to the US chapter 11 procedure which the German Supreme Court recognises<sup>88</sup>. The district court accepts that the Scheme of Arrangement deprives a German creditor of his rights, the latter having had no opportunity to file his claim with the English court. The Celle court of appeal (*Oberlandesgericht*) took a different approach: According to the court, schemes of arrangement do meet the statutory requirements for domestic insolvency proceedings: Schemes of arrangement do not settle claims against the debtor comprehensively, since they do not include the totality of creditors<sup>89</sup>. When the German Supreme Court (*Bundesgerichtshof*) decided on the case, it side-stepped issues of international insolvency law: The court noted that the creditor was enforcing his rights under an insurance contract. European Union law on jurisdiction of member state courts did not bar German courts from deciding on insurance law issues, thus rejecting the binding effect of an English Scheme of Arrangement. This provokes the question under what circumstances national courts have discretion to disobey the standards of comity in cross-border insolvency settings<sup>90</sup>.

## 2. Outlook

Trans-border insolvencies are a test case for universalism. The private international law criterion that the debtor's COMI controls the location of the main proceedings and the applicable law has ushered in a certain degree of consolidation in insolvency law. Both the 'Principles of Cooperation in Trans-national Border Cases' by the American Law Institute<sup>91</sup> and the UNCI-

86 FSA, *FSA process guide to decision making on Schemes of Arrangement*.

87 See judgment of the district court (*Landgericht*) of Rottweil of 17 May 2010, BeckRS 2010, 13330 (beck-online).

88 German Supreme Court (BGH), judgement of 13 October 2009 (X ZR 79/09), available at <http://lexetius.com/2009,3103>.

89 Court of Appeal (*Oberlandesgericht*) of Celle, judgement of 8 September 2009 (8 U 46/09), available at <http://app.olg-niedersachsen.de/efundus/volltext.php4?id=5106>. See, however, the analysis by P. Mankowski, 65 *Wertpapier-Mitteilungen* 1201 et seq. (2011); H. Eidenmüller, Tilmann Frobenius, 65 *Wertpapier-Mitteilungen* 1210, 1217 et seq. (2011).

90 Cf. C. P. Paulus, "Das englische Scheme of Arrangement – ein neues Angebot auf dem europäischen Markt", 32 *Zeitschrift für Wirtschaftsrecht* 1077, 1080 et seq. (2011).

91 The American Law Institute, The International Insolvency Institute (eds.), *The ALI/III Principles of Cooperation in Transnational Cases* (2010), available at <http://www.iiiglobal.org/component/jdownloads/finish/36/5306.html>.

TRAL 'Model Law on Cross-Border Insolvency' foster cooperation in trans-border insolvency proceedings. Empirical studies suggest that the courts of the main and ancillary proceedings cooperate in order to facilitate an efficient distribution of the debtor's assets<sup>92</sup>. Cross-border protocols are the product of private contracting in order to coordinate concurrent insolvency proceedings in several jurisdictions. However, cross-border protocols fall short of establishing ground rules for restructuring contracts.

Anecdotal evidence suggests that privately negotiated restructuring contracts challenge mandatory bankruptcy law and rules for protecting a country's *ordre public* or established public policies. Closer inspection reveals that the crucial point about private ordering in the field of bankruptcy law is creditor participation<sup>93</sup>. Restructuring schemes will only be successful if they can be made binding for a minority of dissenting creditors. Consortium agreements have taken recourse to collective action-clauses<sup>94</sup>. U.S. law on mass bankruptcies demonstrates that (international) creditors should be weary about their due process rights<sup>95</sup>. The movement for 'contractualisation'<sup>96</sup> of insolvency and restructuring laws will have to flesh out rules for minority protection and substantive rules for judicial scrutiny of a scheme of arrangement or any other pre-packaged reorganisation scheme.

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92 I. Mevorach, "On the Road to Universalism: Comparative and Empirical Study of the UNCITRAL Model Law on Cross-Border Insolvency Law", 12 *Eur. Bus. Org. L. Rev. (EBOR)* 518, 537 et seq. (2011).

93 Cf. C. P. Paulus, 32 *Zeitschrift für Wirtschaftsrecht* 1077, 1080 (2011).

94 See Institut für Interdisziplinäre Restrukturierung, *Schemes of Arrangement – Veranstaltungs- und Diskussionsbericht vom 4. Trilog 4. Juni 2011*, available at [http://www.iir-hu.de/fileadmin/Freigaben/Veranstaltungen/Trilog/Trilog\\_4\\_Bericht.pdf](http://www.iir-hu.de/fileadmin/Freigaben/Veranstaltungen/Trilog/Trilog_4_Bericht.pdf).

95 Cf. J. B. Martin, "A User's Guide to Bankruptcy Mediation and Settlement Conferences", 11 *Tenn. J. Bus. L.* 198, 190 (2009).

96 A.-F. Zattara-Gros, *La Contractualisation du Droit de Entreprises en Difficultés*, in *Mélanges en l'honneur de Daniel Tricot* (Daloz 2011), 623 et seq.; P. Mankowski, P. Mankowski, 65 *Wertpapier-Mitteilungen* 1201, 1209 (2011).

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## ПРЕКОГРАНИЧНИ СТЕЧАЈНИ ПРОТОКОЛИ: ОД МЕКОГ ПРАВА ДО ИНОВАТИВНИХ МЕХАНИЗАМА РЕСТРУКТУРИРАЊА?

### Резиме

*Стечај мултинационалних група представља велики изазов за прекограничну заштитну поверилаца. Прекогранични протоколи представљају приватне споразуме којима се врши координација конкурентних стечајних послова који се воде у различитим државама. Овај чланак истражује неколико протокола и њихов потенцијал за реструктурирање. У раду се анализира америчка пракса признања страних планова реструктурирања. Чланак се закључује се механизмима реструктурирања у Европској унији, укључујући и планове поравнања на основу британског Закона о компанијама из 2006. године.*

**Кључне речи:** прекогранични стечајни протоколи, реструктурирање, планови поравнања.