ANDERSON MŌRI & TOMOTSUNE

FINANCIAL RESTRUCTURING GROUP NEWSLETTER

February 2017

Basics of Distressed M&A in the Restructuring Practice in Japan

Yoshihito Shibata / Yuri Ide / Zentaro Nihei

Distressed M&A, where a "sponsor" company purchases a company or business in financial difficulty, has become common in the Japanese restructuring scene. This newsletter is aimed at explaining the basics of Distressed M&A under Japanese restructuring proceedings to non-Japanese investors through a Q&A format.

Q1. What kinds of procedures are available for restructuring in Japan?[1]

For the rehabilitation of debtors, two types of reorganization procedures are available: Corporate Reorganization Proceedings (Kaisha Kosei) and Civil Rehabilitation Proceedings (Minji Saisei). Under these procedures, plans of reorganization or rehabilitation, respectively, are submitted for creditors' approval and court confirmation[2]. Upon the court's confirmation of the plans, creditors' claims will be amended in accordance with the plans.

Under Civil Rehabilitation proceedings, the existing management members of the debtor will generally remain to run the debtor's business under the supervision of a court-appointed supervisor (DIP type proceeding). Under Corporate Reorganization proceedings, the court appoints a trustee, who has the power to administer and dispose of the debtor's business and assets. Subject to the satisfaction of certain requirements, a member of management of the debtor can also be appointed as the trustee to run the debtor's business under the court's supervision (the quasi "DIP-type" corporate reorganization).

Additionally, out-of-court workouts are becoming increasingly popular in Japan. An M&A in an out-of-court workout is regulated by the Companies Act and other applicable laws.

[1] More details of Japanese restructuring procedures are described in the IFLR website: Yuri Ide and Zentaro Nihei "2016 Insolvency and Corporate Reorganization Report: Japan" (http://www.iflr.com/Article/3549971/2016-Insolvency-and-Corporate-Reorganisation-Report-Japan.html)

[2] Creditors' approval is required. For example, under Civil Rehabilitation, consent of more than 50% of creditors voting at the relevant creditors' meeting by headcount, and consent of creditors whose voting rights account for at least half of the total amount of voting rights held by all creditors, are required.

Q2. Can the sale of a debtor's business be concluded before the filing of the plan of reorganization/rehabilitation?

Yes. The sale of a debtor's business on a going concern basis can be implemented outside a plan, and this works similarly to a 363 Sale in the U.S. Such a sale must be court-sanctioned, and the court will only permit it if the court finds it necessary for the rehabilitation of the debtor's business. In determining whether to permit a sale, the court will also take the opinions of creditors and the relevant labor union into account. It should be noted, however, that there is no official hearing or other opportunity for creditors to file an objection against the sale. A sale outside a plan enables a debtor or Trustee to dispose of the debtor's business quickly, sometimes within weeks from the filing of the case[3]. In addition to sales in Civil Rehabilitation and Corporate Reorganization, such quick sales of the debtor's business are available under bankruptcy proceedings[4] as well. In bankruptcy proceedings, sales of the debtors' business can be concluded within days, depending on the urgency of the matter.

On the other hand, Japanese procedures lack some features available under the 363 Sale in the U.S. For example, a 363 Sale enables the transfer of assets "free and clear" of encumbrances, but a debtor under Japanese procedures has to reach an agreement with the secured creditors or obtain court approval before security interests on the transferred assets can be extinguished.

Q3. Can creditors obtain a debtor's shares through a debt-to-equity swap (DES)?

Yes. However, in Japan, a debt-to-equity swap is not as common as in the U.S., especially in the context of in-court restructuring. Japanese banks, that commonly account as the main creditors in many cases, generally have no strong interest in acquiring the debtors' equity. Additionally, there are certain restrictions on Japanese banks holding shares in companies.

Furthermore, debtors typically begin the process of looking for a sponsor at a very early stage of insolvency filings. Once an agreement has been reached between the debtor and the sponsor, and such agreement is approved by the court or the supervisor, it would be difficult for creditors to substitute such agreement with a debt-to-equity swap. In view of these factors, quick action and control over majority claims are crucial for a creditor that is contemplating an acquisition through a debt-to-equity swap.

---

[3] Please refer back to footnote 1.

[4] For the liquidation of companies, bankruptcy proceedings (*Hasan*) and Special Liquidation (*Tokubetsu Seisan*) are available for debtors.

Q4. Is a bid process always required to select the sponsor?

There is no statutory requirement to select a sponsor through a bid process. Sponsor selection, however, has a significant impact on creditors' interests. In this connection, a so-called "Double Standard" theory for sponsor selection in Japanese insolvency proceedings was recently developed by a taskforce of leading Japanese practitioners comprised of lawyers, judges and law professors, among others. This standard encourages the courts to consider, as a fundamental issue, whether a matter is really fit for a sponsor bidding process by taking into account (i) the size of the debtor's business, (ii) the nature of the debtor's business, (iii) whether the debtor is especially dependent on any particular person, and (iv) time constraints (such as the urgency regarding the debtor's cash management). If one or more of these factors render a sponsor bidding process inappropriate (such as where the debtor is too small to justify the costs of a bidding process or where the debtor has an impending cash flow problem), competitive sponsor selection, through a bidding process for example, would be deemed unsuitable, and the debtor's arrangement with a sponsor of its choice would generally be respected.

If a competitive sponsor selection process is deemed to be a reasonable solution, but no bidding process is ultimately implemented notwithstanding that such process is appropriate based on application of the "Double Standard" theory, the reasoning behind the debtor's selection of a sponsor will be closely scrutinized by the court or court appointed Supervisor. If the court considers such selection justifiable, certain requirements (including the procurement of court approval) will have to be satisfied in respect of the debtor's arrangement with a sponsor of its choice before such arrangement may be implemented.

END

- This law bulletin is published as a general service to clients and friends and does not constitute legal advice. Should you wish to receive further information or advice, please contact the below authors.

- Authors :

Yoshihito Shibata, Attorney-at-law
yoshihito.shibata@amt-law.com
Tel: 03-6894-1033
Fax: 03-6894-1034
https://www.amt-law.com/en/professional/profile/YBS

Yuri Ide, Attorney-at-law
yuri.ide@amt-law.com
Tel: 03-6894-1075
Fax: 03-6894-1076
https://www.amt-law.com/en/professional/profile/YRI

Zentaro Nihei, Attorney-at-law
zentaro.nihei@amt-law.com
Tel: 03-6894-2003
Fax: 03-6894-2004
https://www.amt-law.com/en/professional/profile/ZEN

- If you wish to subscribe or unsubscribe to this newsletter, kindly contact us at frg-newsletter@amt-law.com.

- Previous issues of our newsletters are available on the website of Anderson Mori & Tomotsune.

  http://www.amt-law.com/bulletins15.html