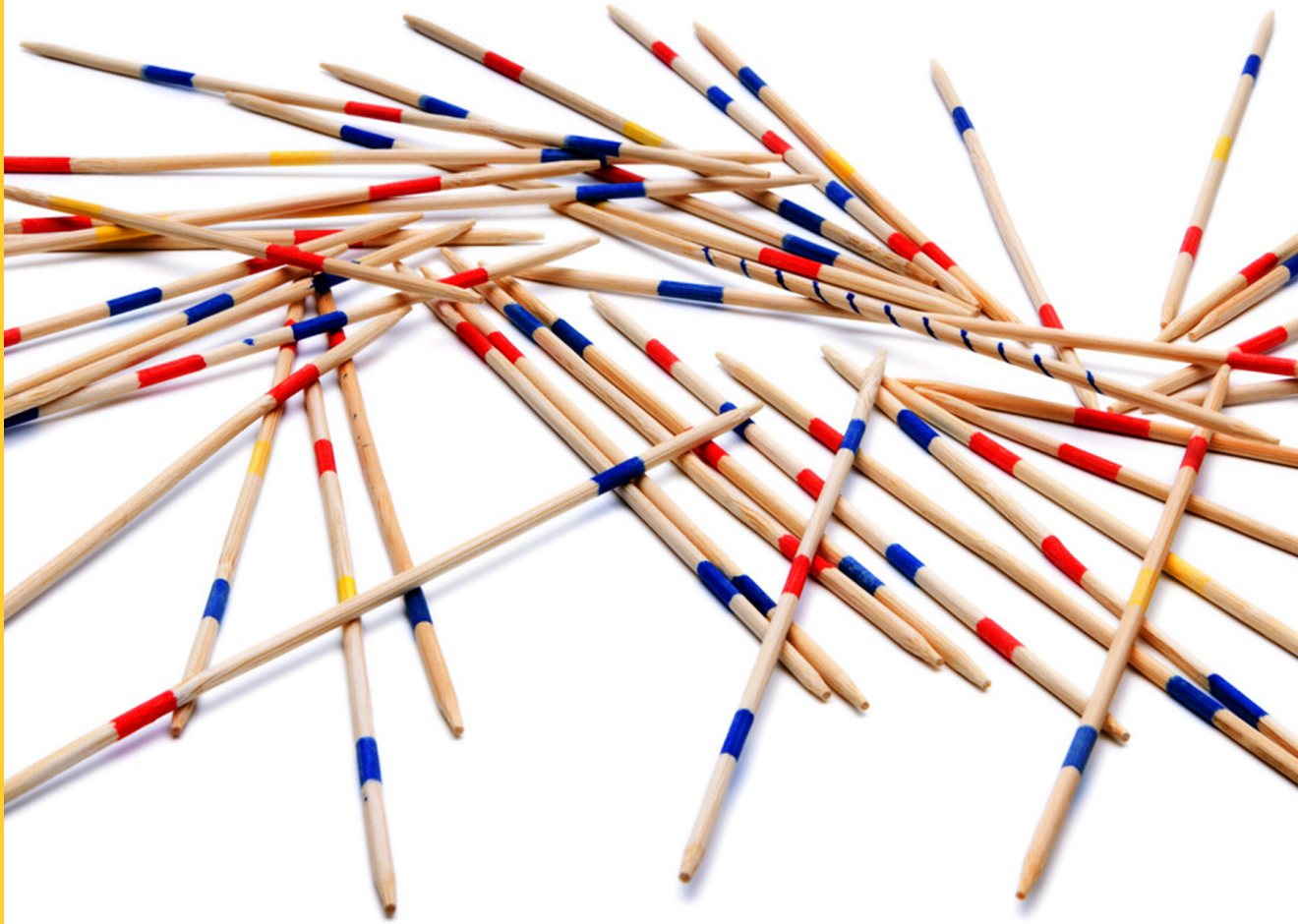

Insolvency and Corporate Reorganisation Report **2017**

Featuring contributions from

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Anderson Mori & Tomotsune
BlackOak
Cleary Gottlieb Steen & Hamilton
European Commission
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INTERNATIONAL FINANCIAL LAW REVIEW

Japan

Yuri Ide and Zentaro Nihei, Anderson Mori & Tomotsune

SECTION 1: Market overview

Anderson Mōri & Tomotsune

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1.1 What have been the recent bankruptcy and reorganisation trends or developments in your jurisdiction?

The number of bankruptcy and in-court reorganisation cases has been declining. This is due in large part to the government's encouragement of lending banks to take a more flexible approach toward small and medium-sized enterprises (SMEs). As a result, many SMEs have managed to postpone repayment of their debts for many years through out-of-court discussions with their lenders.

However, companies with irremediable financial problems, who are therefore unlikely to reach out-of-court restructuring arrangements with their creditors, are still required to undergo bankruptcy or reorganisation proceedings. Such proceedings have become increasingly complex due to the growing number of Japanese companies maintaining overseas operations, which entails the need to consider the global business as a whole when making restructuring arrangements.

1.2 Please review some recent important cases and their impacts in terms of precedents or shaping current thinking.

Due to the recent downturn in the maritime sector, there have been a number of judicial and out-of-court reorganisations of shipping companies where cross-border issues have had to be considered. The Sanko Shipping and Daiichi Chuo Shipping cases, for example, involved filings in multiple jurisdictions for recognition of and assistance for insolvency proceedings in Japan. Correspondingly, Japanese courts have also issued recognition and assistance orders for the reorganisation proceedings of several Korean shipping companies, including Hanjin Shipping Co.

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About the author

Yuri Ide is a partner at Anderson Mori & Tomotsune, and has been principally involved in cross-border insolvency and restructuring cases, in which she represents debtors, investors and creditors in various industries. Her recent work includes the representation of Japanese banks and international ad hoc bondholders groups in corporate reorganisation cases and the representation of debtors' out-of-court workouts and civil rehabilitation. She has extensive experience in M&A, litigation and crisis management matters, especially in an international context.

Ide has served as the co-chair of the Japan chapter of the International Women's Insolvency and Restructuring Confederation (IWIRC) since 2012 and is a frequent speaker on the cross border insolvency issues at the IBA, Tokyo Bar Association and others. Before joining Anderson Mori & Tomotsune in April 2015, Ide was a partner at Bingham Sakai Mimura Aizawa.

SECTION 2: Processes and procedures

2.1 What reorganisation and insolvency processes are typically available for debtors in your jurisdiction?

Four types of insolvency proceedings are available in Japan for the rehabilitation of companies in financial difficulty. These are: corporate reorganisation proceedings (*kaisha kosei*); civil rehabilitation proceedings (*minji saisei*); bankruptcy proceedings (*hasan*); and, special liquidation proceedings (*tokubetsu seisan*).

Corporate reorganisation proceedings are typically used in complex insolvency cases involving stock companies. They come with the mandatory appointment of a reorganisation trustee by the court and with a stay against enforcement by both secured and unsecured creditors. The court typically appoints a third-party lawyer (*bengoshi*) with substantial experience in restructuring cases as the trustee. Since 2009, however, the Tokyo District Court (TDC) has begun the so-called quasi-debtor in possession (DIP) type practice, under which the debtor's director or counsel is appointed as the trustee. In quasi-DIP proceedings, the court appoints an examiner to supervise the trustee's administration of the reorganisation.

Civil rehabilitation proceedings (*minji saisei*) are used to rehabilitate companies of almost any size and type, and for the rehabilitation of individuals. In civil rehabilitation proceedings, the DIP administers the rehabilitation under the supervision of a court-appointed supervisor. In civil rehabilitation proceedings, enforcement by secured creditors is not stayed, in principle. Accordingly, the debtor has to enter into settlement agreements with secured creditors in order to continue using the relevant collateral to conduct their businesses.

Bankruptcy (*hasan*) and special liquidation (*tokubetsu seisan*) proceedings are used when the liquidation and dissolution of the debtor is contemplated.

In bankruptcy proceedings, the court appoints a lawyer as trustee to administer the bankruptcy procedures. Enforcement by secured creditors is not stayed. Rather, the secured creditors can freely exercise their claims outside of the bankruptcy proceedings. Notwithstanding, the trustee will usually attempt to sell secured collateral with the agreement of the secured creditors and contribute a percentage of the sales proceeds to the estate. The debtor's estate is distributed to creditors in accordance with prescribed statutory priorities without any need for voting by the creditors.

Special liquidation proceedings are used for stock companies. Under these proceedings, a liquidator is appointed by a debtor's shareholders or the court. Distribution of the debtor's estate to creditors has to be approved by creditors with claims to two-thirds or more of the debtor's total debts or by way of settlement among the creditors. Special liquidation is typically used when the debtor's shareholders are confident of obtaining the creditors' cooperation for the liquidation process and wish to control the liquidation process without the involvement of a trustee.

In bankruptcy, the court must find that the debtor is insolvent on a balance sheet basis or unable to pay its debts as they become due generally and on a continuing basis before it commences the case. In corporate reorganisation and civil rehabilitation, the court must find that the company faces the threat of a bankruptcy event (as described above), or would likely greatly impair its own operations if it paid its debts as they became due before it commences the case.

Under each of the four types of insolvency proceedings, there is usually a so-called gap period between the date of filing and the date of commencement of proceedings during which the court examines the grounds for commencement of proceedings. The duration of the gap period varies from case to case, but is typically one month for corporate reorganisations and one week for other proceedings.

2.2 Is a stay on creditor enforcement action available?

Additional filing for an injunction order is necessary to obtain a stay of creditor enforcement for the gap period. This injunction order expires at the commencement of the proceedings, when creditor enforcement is automatically stayed.

Enforcements of secured claims are stayed in corporate reorganisations but are generally not stayed in other types of proceedings. The exercise of rights of set-off cannot be stayed. However, such rights have to be exercised by the claim bar date in corporate reorganisation and civil rehabilitation proceedings.

2.3 How could the reorganisation and/or insolvency processes available in your jurisdiction be used to implement a reorganisation plan?

Debtors and creditors can file corporate reorganisation and civil rehabilitation. Shareholders holding more than ten percent of voting rights may also file corporate reorganisation.

Creditors have to file the claims by the bar date which is set by the court at the time of the commencement of the case. The claims are examined by the trustee in the corporate reorganisation and by the DIP in the civil rehabilitation.

The trustee evaluates the debtor's assets on a market value basis in the corporate reorganisation. In civil rehabilitation, the evaluation by the DIP is made based on the liquidation value.

The plan is proposed by the trustee or the DIP in corporate reorganisation and civil rehabilitation proceedings. Although creditors are also entitled to file a plan in such proceedings, it is rare for creditors to file a plan because the involvement of, and disclosure of financial details to, creditors is generally limited in Japanese insolvency proceedings. However, in some cases, the court approves the creditors' competing plan for voting and a proxy fight takes place at the court.

In corporate reorganisations, creditors are categorised into the classes of secured creditors and unsecured creditors for voting. Passing a reorganisation plan requires the approval of secured creditors representing two thirds or more of the value of secured claims and of unsecured creditors representing a simple majority of the value of unsecured claims. Under plans of reorganisation, secured claims are usually paid in full up to the value of the relevant collateralised assets, with only the payment schedules amended. However, a plan that provides for a haircut or other amendments to secured claims requires the approval of secured creditors representing three quarters or more of the value of secured claims.

In civil rehabilitation cases, where secured claims are freely exercisable outside of the proceedings, only unsecured creditors (including secured creditors with deficiency claims) vote on the plan of rehabilitation. Claims are generally grouped into a single unsecured class. However, contractually subordinated claims are put into a separate class and the creditors of those subordinated claims are not entitled to vote on the plan if the debtor is insolvent on its balance sheet.

A plan of rehabilitation requires the votes of a majority of creditors voting on the plan, provided they also represent a simple majority of the value of claims.

2.4 How can a creditor or a class of creditors be crammed down?

Notwithstanding the disapproval of a plan by a class of creditors, a court has the power in both corporate reorganisation and civil rehabilitation proceedings to approve a plan if it finds it fair and equitable, as long as one of the classes of creditors approves the plan. Whether the best interest rule (payouts under the plan are larger than payouts in liquidation) is satisfied is a critical factor in assessing whether a plan is fair and equitable.

2.5 Is there a process for facilitating the sale of a distressed debtor's assets or business?

To facilitate the sale of the debtor's assets, the court can approve the sale of the debtor's business outside of the plan, if a prompt sale is necessary to rehabilitate the debtor's business. Although the court is obliged to take into account the views of creditors, no formal voting on the sale is required. This is similar to a 363 sale under Chapter 11 of the US Bankruptcy Code, except that creditors have no right to file a formal objection to the sale in Japanese proceedings.

Credit-bidding is prohibited under Japanese insolvency proceedings because it can constitute the set-off between pre-filing claims and post-filing obligations (in view of the fact that buyers' obligations to pay the purchase price typically accrue post filing). Although so-called stalking horse bids are not expressly prohibited under Japanese law, there are no precedents of such bids in Japanese insolvency proceedings.

2.6 What are the duties of directors of a company in financial difficulty?

The directors do not have to file insolvency proceedings when the company faces financial difficulty, because they have broad discretion on the company's management. However, the creditor may pursue the directors' personal liability under a special provision in the Companies Act: if the creditor proves that the directors permitted the company to enter into a transaction that they knew or should have known that the

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About the author

Zentaro Nihei is a partner at Anderson Mori & Tomotsune. His practice focuses on financial restructuring and workouts, representing a wide range of debtors, creditors and distressed investors globally. He has advised major financial institutions on some of the largest restructuring deals, whether in the context of cross-border M&A, crisis management or otherwise. Some of his representative work include acting for a secured lenders committee in a large scale civil rehabilitation proceeding, supporting prominent financial institutions and funds in cross-border insolvency proceedings, and assisting foreign lenders against Japanese debtors. He also has extensive experience in representing and advising sponsors on a broad range of matters in distressed M&A.

Nihei has several years of experience working in New York and London at the Boston-based international law firm Bingham McCutchen, and at Sumitomo Mitsui Banking Corporation Europe, where he advised on the legal aspects of debt restructuring. He is a Japan and New York qualified lawyer.

company subsequently would be unable to perform due to the company's financial difficulty.

2.7 How can any of a debtor's transactions be challenged on insolvency?

The trustee in the corporate reorganisation and the supervisor in the civil rehabilitation have the power to avoid the debtor's transactions if they satisfy the conditions to be deemed as fraudulent transfers or preferences.

Executory contracts can be rejected by the trustee or the DIP. In principle, the counter party's claims to recover the consideration can be qualified as administrative claims but the damages due to the rejection is treated as pre-petition claims which can be modified by the plan.

2.8 What priority claims are there and is protection available for post-petition credit?

Post-petition credits qualify as administrative claims that must be paid in full in accordance with the contractual terms. However, where proceedings transition from corporate reorganisation or civil rehabilitation to bankruptcy, administrative claims can be paid only on a pro rata basis if the estate does not have enough funds to satisfy all administrative claims. There is no equivalent of the US Chapter 11 priming lien or super priority systems in Japan.

2.9 Is there a different regime for banks and other financial institutions?

The Deposit Insurance Act of Japan was amended in 2014 to introduce a system for the orderly resolution of financial institutions based on the Key Attributes published by the FSB in 2011. This system enables the transfer of the critical functions to bridge institutions and temporary stays against the termination of derivative agreements through the power of the resolution authorities. Where insolvency proceedings are commenced in respect of financial institutions, the Reorganization Special Measures Act (*Kosei Tokurei Ho*) will be triggered to facilitate handling of the vast number of depositors and policyholders who are deemed creditors. The Deposit Insurance Bank of Japan (DICJ) and the Life Insurance Policyholders Protection Corporation of Japan provide financial protection of insured deposits and insurance benefits, and will also establish bridge institutions if time is required to locate a buyer for the businesses or assets of the financial institution in question.

SECTION 3: International/cross-border issues

3.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Yes. A foreign debtor with business premises in Japan has the right to file for civil rehabilitation or bankruptcy in Japan. Corporate reorganisation is also an available option for a foreign debtor that is similar in nature to a Japanese stock company.

3.2 Can recognition and assistance be given to foreign insolvency or reorganisation proceedings?

Yes. Under the Law on Recognition of and Assistance in Foreign Insolvency Proceedings (*Shonin Enjo Ho*), which is modelled on the United Nations Commission on International Trade Law (UNCITRAL) Model Law, the TDC has the power to recognise and assist foreign bankruptcy and reorganisation proceedings.

SECTION 4: Other material considerations

4.1 What other major stakeholders could have a material impact on the outcome of the reorganisation?

Governmental and regulatory institutions in principle are not required to be materially involved in the reorganisation of private enterprises unless the reorganisation relates to a financial institution. Nevertheless, their involvement may sometimes be necessary for continuation of the debtor's business. For example, if a debtor needs a certain regulatory licence to conduct its business, and such licensing is conditional upon the debtor having good financial health, close or prior consultation with the relevant regulator would be essential for the debtor to retain its licence, smoothly conduct its business and remain saleable to a sponsor.

Also, some large Japanese corporations have been rescued with the support of government-backed funds, which helped to secure the cooperation and coordinate the response of creditors, thereby preserving the enterprise value of the debtor. One of the largest governmental funds of this kind is the Innovation Network Corporation of Japan, which played a significant role in the shoring up of Japan Display and Renesas Electronics Corporation.

SECTION 5: Outlook 2017

5.1 What are your predictions for the next 12 months in the corporate reorganisation and insolvency space and how do you expect legal practice to respond?

Out-of-court workouts are increasingly preferred over corporate reorganisation and civil rehabilitation. There are several out-of-court workout schemes available in Japan, such as the Turnaround ADR (*Jigyo Saisei* ADR), the process of which is supervised by a mediator, and the scheme administered by the REVIC (a state-owned organisation which facilitates workouts by coordinating the activities of lenders and provides financing to the debtor).

The key differences between workouts and court proceedings are the level of protection for trade creditors and the extent of creditors' consents required for successful restructuring. Trade creditors are paid in full in out-of-court workouts. Such protection is not guaranteed in court proceedings. However, in recent cases, the protection of trade claims in court proceedings has been expanded to preserve the value of the debtor's business. Regarding the creditors' consents, the unanimous consent of affected financial creditors is required to settle in out-of-court workouts, while the plans can be approved by majority creditors in the court proceedings. Some new legislation or changes in practice to facilitate out-of-court workouts that lack the consent of a small number of creditors is under consideration.