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Japan

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Law and Practice

Contributed by Anderson Mori & Tomotsune

Contents

Anderson Mori & Tomotsune is a full-service corporate law firm that ranks among the largest in Japan, and specialises in serving overseas, multinational clients doing business in Japan. The Bankruptcy and Insolvency/Restructuring team provides comprehensive legal services in all aspects of financial restructuring and insolvency/bankruptcy issues, representing creditors, creditors' committees, debtors, sponsors and other stakeholders in matters ranging from large-scale restructuring and insolvency cases to small regional business restructurings. The lawyers support clients in the negotiation and co-ordination of conflicting interests amongst stakeholders, in voluntary and involuntary filings, and in the execution of various in-court proceedings and out-of-court workouts between creditors and borrowers. The team has particular expertise in distressed M&A transactions, including structuring and due diligence, and in dealing with labour issues.

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1. Market Trends and Developments

1.1 The State of the Restructuring Market

In Japan, there are four types of judicial insolvency proceedings available for the debt-restructuring of companies in financial distress: (i) corporate reorganisation, (ii) civil rehabilitation, (iii) bankruptcy, and (iv) special liquidation. Corporate reorganisation and civil rehabilitation are revitalisation (reorganisation/rehabilitation) proceedings while bankruptcy and special liquidation are liquidation proceedings. Out-of-court workouts (ie, out-of-court debt-restructuring through agreements among the target creditors and the debtor) are also common in Japan.

In recent years, there has been a significant drop in corporate reorganisation and civil rehabilitation proceedings. Specifically, there were 230 cases of civil rehabilitation in 2017 compared to, for example, 2002, when there were 1,093 cases. By contrast, recent years have seen a rise in the number of out-of-court workouts where debtor companies and lender banks reach agreement on a plan of reorganisation under which debt repayment is rescheduled or discharged.

This trend is attributable to several factors. First, the Japanese government has enacted several statutes that facilitate systematised out-of-court proceedings such as the Turnaround ADR scheme, the REVIC scheme, and the SME Rehabilitation Support Association scheme. Second, out-of-court workout proceedings provide lender banks with more information and transparency about a debtor's business and financial condition than court proceedings. Third, the value of a debtor's business will not be impaired by out-of-court workouts because, in general, trade creditors are not involved in such workouts and the existence of such workouts are known only to the lender banks. For the above reasons, banks are also more likely to enjoy better recovery rates than they would under court proceedings.

The prevalence of out-of-court workouts is also due to the after-effects of the so-called Moratorium Law (precisely, the Act Concerning Temporary Measures to Facilitate Financing for Small to Medium-sized Enterprises), which was enacted in 2009 and expired in 2013. Under the Moratorium Law, Japanese banks were obliged to endeavour to lessen the burden of debts owed by Small to Medium-sized Enterprises ("SMEs") to the extent possible by taking measures such as change of terms and conditions of debts, refinance of debts, debt-to-equity swap and so forth, if so proposed by the SMEs. Notwithstanding the expiration of the Moratorium Law, the Japanese government still enjoined banks to continue with the same approach toward SMEs as if the law were still in effect. This has helped distressed SMEs, which would otherwise have gone bankrupt, continue in operation. Accordingly, the Moratorium Law is often criticised as protecting so-called zombie companies.

On the other hand, corporate bankruptcy and special liquidation proceedings are on an upward trend. Specifically, there were 7,830 corporate bankruptcy cases in 2017 compared to, for example, 2002, when there were 3,203 such cases. Special liquidation is often used for liquidating the loss-making components of a company after the profit-generating component has been split off to a third party.

1.2 Changes to the Restructuring and Insolvency Market

The most noteworthy development in the area of insolvency is the government's plan to take a step to introduce majority rule to out-of-court workouts.

As discussed above, out-of-court workouts have been increasing in recent years, and are generally preferred over judicial insolvency proceedings. However, in light of the right to property, which right is guaranteed as inviolable under the Constitution of Japan, there has been general understanding that, in out-of-court workouts, a reorganisation plan involving re-scheduling or discharge of claims shall be approved by unanimous consent by the creditors involved in the plan (in most cases, banks and other financial creditors). Accordingly, even if only one creditor is against a reorganisation plan in an out-of-court workout, the workout will result in failure, such that the debtor would have to file for judicial insolvency proceedings instead. This result is often criticised by insolvency professionals as harmful to business reorganisation.

Under such circumstances, the government released the Japan Revitalisation Strategy 2016 on 2 June 2016, stating that: *"In order to enable companies to proceed with business rehabilitation quickly and smoothly even in case of there being creditors opposing to out-of-court workout proceeding, the related government bodies will consider a legal framework, based on details of the report by the panel of experts."*

Given this background and as a result of a series of considerations, it is concluded that the majority rule shall not be adopted in the out-of-court workout regime itself, however, the reorganisation plan of the failed workout should be utilised in the immediately following judicial insolvency proceeding so that the plan will be approved by the majority of the creditors and implemented smoothly in such following proceeding.

For the purpose of achieving the goal above, treatment of trade claims is an important issue. Trade claims (most of which are small amount claims) are usually not involved in or affected by the out-of-court workout, but they would be affected by the judicial insolvency proceedings if no measures were taken. From this viewpoint, the Act on Strengthening Industrial Competitiveness has been amended and enforced in July 2018 to implement the following special rules in civil rehabilitation proceedings and corporate reorganisation proceedings after the failure of out-of-court

workouts: (i) confirmation of small amount claims, which need to be paid promptly to avoid significant hindrance to the continuation of debtor's business, by Specified Certified Dispute Resolution Business Operators; (ii) process for the court to consider the above confirmation upon issuing the restraining order to prohibit or the permission of the repayment of such small amount claims; and (iii) process for the court to consider the above confirmation upon examining whether equity will be undermined by the preferential treatment of small amount claims in the reorganisation plan.

In summary, the above-mentioned rules will request the court to take account of the decisions relating to treatment of the small amount claims made by Specified Certified Dispute Resolution Business Operators in out-of-court workouts, and it is expected that such rules will support the continuity relating to the treatment of small amount claims between the out-of-court workouts and the following judicial insolvency proceedings.

In addition, Tokyo District Court has announced a "fast-track" schedule of civil rehabilitation proceedings for the case following the failure of out-of-court workouts and it is expected to proceed quickly and smoothly by utilising the financial analysis, business plan and the reorganisation plan prepared in the preceding out-of-court workout.

2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

2.1 Overview of the Laws and Statutory Regimes

The statutory insolvency and restructuring proceedings in Japan can be categorised into (i) proceedings for revitalisation and (ii) proceedings for liquidation.

Civil Rehabilitation

Civil rehabilitation proceeding (*minji-saisei*) is the proceeding for revitalisation and can be used for a company of any size and type to rehabilitate its business operations in accordance with a rehabilitation plan. Even after the commencement of civil rehabilitation proceedings, the debtor company is usually managed and operated by the same management, as debtor-in-possession ("DIP") under the oversight by the court and the supervisor appointed by the court.

Corporate Reorganisation

Corporate reorganisation proceeding (*kaisha-kosei*) is also the proceeding for revitalisation and can be used only for stock companies (*kabushiki-kaisha*). The aim of corporate reorganisation proceedings is to maintain and reorganise the business and assets of a debtor company in accordance with a reorganisation plan. The court appoints a reorganisation trustee to manage and operate the debtor's business and assets in corporate reorganisation proceedings. Under traditional practice, the court usually appoints an experienced insolvency lawyer as a reorganisation trustee; recently, however, the court has sometimes appointed the management of a debtor company as a trustee to keep continuous management and operation of the debtor's business. Unlike other types of statutory insolvency and restructuring proceedings, creditors' rights are more restricted compared to other proceedings to ensure the successful restructuring as represented by the restriction on security interests, which are subject to stay and amendment in corporate reorganisation proceedings.

Bankruptcy

Bankruptcy proceeding (*hasan*) is the proceeding for liquidation and can be used for a company of any size and type to liquidate the business and assets of a debtor company properly and fairly. In bankruptcy proceedings, the court appoints a trustee to liquidate the debtor's assets into cash and distribute such collected cash to the creditors. In the failure of civil rehabilitation or corporate reorganisation proceedings, they will be converted to bankruptcy proceedings.

2.2 Types of Voluntary and Involuntary Financial Restructuring, Reorganisation, Insolvency and Receivership

Usually, each type of statutory insolvency and restructuring proceedings – referred to in **2.1 Overview of the Laws and Statutory Regimes** above – is commenced by a petition filed by the debtor. However, in certain cases, creditors (and shareholders in the case of corporate reorganisation proceedings) may file a petition for commencement of the proceedings. For further details about the petition by creditors, please see **2.6 Ability of Creditors to Commence Insolvency Proceedings**, below.

2.3 Obligation to Commence Formal Insolvency Proceedings

Under Japanese law, companies and directors thereof are not statutorily obligated to file for formal insolvency proceedings even when they become insolvent. However, there is a theory that, under certain circumstances, directors of an insolvent company owe a duty of care to consider filing for formal insolvency proceedings for the purpose of mitigation of the creditors' losses.

2.4 Procedural Options

Please see **2.3 Obligation to Commence Formal Insolvency Proceedings**, above.

2.5 Liabilities, Penalties or Other Implications for Failing to Commence Proceedings

Please see **2.3 Obligation to Commence Formal Insolvency Proceedings**, above.

2.6 Ability of Creditors to Commence Insolvency Proceedings

Bankruptcy Proceedings

A creditor can file a petition for commencement, if (i) the debtor, due to the lack of ability to pay, is generally and continuously unable to pay its debts as they become due and payable, or (ii) the debtor is unable to pay its debts in full with its assets.

Civil Rehabilitation Proceedings

A creditor can file a petition for commencement, if it is likely that a fact constituting a ground for commencement of bankruptcy proceedings (as described above) will occur with respect to the debtor.

Corporate Reorganisation Proceedings

A creditor (or creditors) holding claims equal to 10% or more (in total) of the paid-in capital of the debtor can file a petition for commencement if it is likely that a fact constituting a ground for commencement of bankruptcy proceedings (as described above) will occur with respect to the debtor.

2.7 Requirement for Insolvency to Commence Proceedings

Cash-flow insolvency (ie, inability to pay debts generally and continuously when they become due) or balance-sheet insolvency (ie, excess of debts to assets) is required for commencement of bankruptcy proceedings (please see **2.6 Ability of Creditors to Commence Insolvency Proceedings**, above).

2.8 Specific Statutory Restructuring and Insolvency Regimes

With respect to financial institutions, securities companies and insurance companies, specific regimes of corporate reorganisation proceedings, civil rehabilitation proceedings and bankruptcy proceedings will be applicable.

3. Out-of-court Restructurings and Consensual Workouts

3.1 Consensual and Other Out-of-court Workouts and Restructurings

For a distressed debtor trying to restructure its business without filing a petition for statutory insolvency and restructuring proceedings, it is usual to first attempt to seek an agreement with creditors outside the court. Such out-of-court consensual workouts are generally preferred to statutory proceedings among restructuring market participants and professionals, since they are generally perceived to be more appropriate and flexible in terms of maintaining the value of the debtor's business and, if successful, are more cost and time-efficient.

The main differences between out-of-court consensual workouts and statutory insolvency and restructuring proceedings are (i) the treatment of trade creditors, and (ii) the requirement for creditors' consents to complete the process.

As to the treatment of trade creditors, essentially they are subject to a haircut (discharge) of debts and only get paid on a pro rata basis in statutory insolvency and restructuring proceedings. In contrast, trade creditors are generally paid in full in out-of-court consensual workouts and, as a result, only the financial creditors will be affected by and involved in such workouts. Such arrangement to pay trade creditors in full will help the debtor to maintain the value of its business by avoiding damages to the relationship with trade creditors supporting the debtor's business after restructuring and limiting the scope of participants to the confidential discussion and negotiation for such workouts.

To complete out-of-court consensual workouts, unanimous consent of all involved creditors (target creditors) is required, while consent of the majority of the creditors is required to approve a plan binding all creditors in statutory insolvency and restructuring proceedings.

3.2 Typical Consensual Restructuring and Workout Processes

Among out-of-court consensual workouts, the debtors may choose to apply for an out-of-court consensual workout with a statutory framework, such as (i) the Turnaround ADR (*jigyo-saisei ADR*), (ii) the scheme administered by the Regional Economy Vitalization Corporation of Japan ("REVIC"), and (iii) the SME Rehabilitation Support Association scheme.

Under these statutory frameworks for out-of-court consensual workouts, the debtors have to follow certain procedures and satisfy several financial conditions to complete the workout process. The debtor may also choose to structure a voluntary arrangement without using any of the above-mentioned statutory frameworks and negotiate with creditors to structure a scheme satisfactory for the debtors and creditors to be affected by such scheme.

As an example of the process of workout with a statutory framework, a summary of the process of Turnaround ADR proceeding is as follows.

The process of Turnaround ADR proceeding is initiated by a debtor's application to the Japanese Association of Turnaround Professionals (JATP). If the debtor's application meets certain requirements, the debtor and the JATP will jointly send a standstill notice to the target creditors (as a general rule, financial creditors) to request not to make any collection, obtain new collateral or guarantee, or file a petition for statutory insolvency or restructuring proceedings against the debtor.

After such a standstill notice, the first meeting with the target creditors will be held within two weeks from the dispatch of such notice to:

- agree on the scope and period of standstill;
- appoint certain number of independent practitioner(s) as the mediator(s) to supervise the process;
- explain an outline of the restructuring plan; and
- determine the schedule of second and third meeting.

The second meeting is to explain the details of the restructuring plan and will be held within one month-and-half from the first meeting. The third meeting is to approve the restructuring plan and will be held within one month from the second meeting.

The above summary only indicates the standard process and timeline of the Turnaround ADR proceeding and any specific process and timeline will be decided on a case-by-case basis.

During the Turnaround ADR proceeding, the debtor will provide the necessary explanation about the restructuring plan to obtain consents from creditors and, in addition, the mediators will prepare a report about the restructuring plan to provide an opinion whether such plan is fair, appropriate and economically reasonable.

Any change to the contractual priority, security/lien priority and any other positions of competing creditors will be made through an agreement to the restructuring plan by all the target creditors.

3.3 Injection of New Money

Any injection of new money to the distressed debtor during the process of out-of-court consensual workouts will be typically made by the potential sponsor (if any), main financing banks or any other large creditors based on the consensus that a claim relating to such injection will not be subject to any amendment as a result of such workouts. Such consensus will be reflected in the final restructuring plan to repay such new money prior to any other claims.

In principle, if the process of out-of-court consensual workouts fails to complete, no priority rights will be granted in the statutory insolvency and restructuring proceedings thereafter. However, it would be obviously difficult to find any lender who is willing to take the risk of failure of out-of-court consensual workouts.

To avoid the situation that a workout fails due to the lack of new money, in case of the injection during the process of Turnaround ADR, the debtor may request Specified Certified Dispute Resolution Business Operators to confirm that (i) the lending of new money is indispensable for the continuation of its business, and (ii) all creditors participating in the process of Turnaround ADR agree to the preferential repayment of debt relating to such lending.

In civil rehabilitation proceedings and corporate reorganisation proceedings, it is permitted to make a different treatment between the general unsecured creditors unless equity will not be undermined and, even in case of a failure of Turnaround ADR after the injection of new money thereunder, it would be possible to provide a preferential treatment for the lender of such injection in the reorganisation plan prepared in the following civil rehabilitation proceedings or corporate reorganisation proceedings.

The above-mentioned confirmation by the Specified Certified Dispute Resolution Business Operators during the preceding Turnaround ADR will be taken into consideration by the court in the following civil rehabilitation or corporate reorganisation proceedings, when it checks the reorganisation plan to see whether a preferential treatment in the plan can be permitted from the perspective of equity.

3.4 Duties of Creditors to Each Other, or of the Company or Third Parties

There are no specific duties imposed on creditors or any other related third parties by any applicable laws or legal doctrines under the out-of-court consensual workouts.

3.5 Consensual, Agreed Out-of-court Financial Restructuring or Workout

To accomplish and effectuate a restructuring plan in out-of-court consensual workouts, the debtor shall obtain consents from all affected creditors; there is no mechanism to effectuate the plan over the dissent of any minority creditors. If the debtor fails to obtain consents from all affected creditors, such debtor may need to consider filing for statutory insolvency and restructuring proceedings; however, under certain circumstances, the progress made in the preceding out-of-court consensual workout can be utilised as explained in **1.2 Changes to the Restructuring and Insolvency Market**, above.

4. Secured Creditor Rights and Remedies

4.1 Type of Liens/Security Taken by Secured Creditors

Secured creditors may take various type of liens/security, such as a mortgage (*teito-ken*), a pledge (*shichi-ken*), a statutory lien (*sakidori-tokken*) or a retention right (*ryuchi-ken*).

A mortgage (*teito-ken*) is a security interest created over real estate and it is the most common security interest. A mortgage is created through an agreement between a creditor (mortgagee) and an owner of the collateral (mortgagor) without transferring the ownership of the collateral, and the

mortgagee has the right to receive preferential payments in a foreclosure or sale of the collateral upon the debtor's default. To perfect a mortgage, registration of the mortgage is required.

A pledge (*shichi-ken*) is a security interest created over immovable property, movable property or claims. A pledge is created through an agreement and physical delivery of the collateral without transferring the ownership of the collateral, and the pledgee has the right to receive preferential payments in a foreclosure or sale of the collateral upon the debtor's default. To perfect a pledge over immovable property, registration of the pledge is required. To perfect a pledge over movable property, the pledgee must retain possession of the collateral. To perfect a pledge over claims, registration of the pledge (if the collateral is owned by a company), or, a notice to the obligor or a consent from the obligor with a certified date is required.

A statutory lien (*sakidori-tokken*) is a security interest over certain movable or immovable property, which is held by a person who has a claim that arose from certain statutory causes.

A retention right (*ryuchi-ken*) is a security interest over a movable or immovable property and the person who physically possesses such property has a right against the owner to retain such property in order to secure a claim that has arisen with respect to the property. Under civil rehabilitation, corporate reorganisation or bankruptcy proceedings, a retention right under the Commercial Code or the Companies Act (*shoji-ryuchi-ken*) is treated as a security interest. In contrast, a retention right under the Civil Code (*minji -ryuchi-ken*) does not have any priority as a security interest.

4.2 Rights and Remedies for Secured Creditors

Civil Rehabilitation Proceedings

In civil rehabilitation proceedings, a secured creditor holds a "right of separate satisfaction" (*betsujo-ken*) and is entitled to enforce its security interest through a foreclosure or sale of the collateral outside of the proceedings. From the proceeds of a foreclosure or sale of the collateral, a secured creditor will be repaid prior to other creditors. If a claim is not paid in full from the proceeds of such foreclosure or sale, the remaining balance of the claim is treated as an unsecured claim and will be repaid in accordance with the rehabilitation plan.

In case of such enforcement of security interest in civil rehabilitation proceedings, the court may order a stay of the enforcement when it finds that the stay conforms to the common interest of rehabilitation creditors and is not likely to cause undue damage to the secured creditor.

In addition, the court may order a permission to extinguish a security interest over the debtor's property, if such property is indispensable for the continuation of the rehabilitation debtor's business. The debtor shall deposit cash equivalent to the value (as determined by the debtor or, in case of dispute about valuation, the court) of the property. The deposited cash may be distributed by the court among the holders of secured interests over the property.

Bankruptcy Proceedings

In bankruptcy proceedings, a secured creditor is also entitled to enforce its security interest through a foreclosure or sale of the collateral outside of the proceedings. From the proceeds of a foreclosure or sale of the collateral, a secured creditor will be repaid prior to other creditors. If a claim is not paid in full from the proceeds of such foreclosure or sale, the remaining balance of the claim is treated as an unsecured claim and will be repaid in the distribution process under the bankruptcy proceedings.

In bankruptcy proceedings, the court may order a permission to extinguish a security interest over the debtor's property, if it is in the common interest of creditors to extinguish such security interest and sell the property free and clear from any security interest. In the petition for the above permission, the trustee is required to clarify the amount to be deducted from the sales proceed for the distribution to other creditors and, if such amount is unacceptable for the creditor with security interest over the property, such creditor may either (i) foreclose the security interest, or (ii) make an offer to purchase the property at an amount not less than 105% of the sales proceeds offered by the trustee.

Corporate Reorganisation Proceedings

In corporate reorganisation proceedings, a secured creditor cannot enforce its security interest outside of the proceedings. Any payment to a secured creditor is prohibited upon the commencement of the corporate reorganisation proceedings and will be made only in accordance with the reorganisation plan.

The trustee makes the valuation of the collateral based on the fair market value as of the date of the commencement of the proceeding. The amount of such valuation will be the amount of a secured reorganisation claim – the amount exceeding the value of the collateral will be the amount of a general unsecured claim.

Upon a petition from the trustee, the court may extinguish a security interest over the debtor's asset, if the court finds it necessary for the reorganisation of the debtor's business. The trustee shall deposit cash equivalent to the value (as determined by the trustee or, in case of dispute about valuation, the court) of the property.

Unlike the US Chapter 11, there is no concept similar to "super-priority" or "priming lien" in Japanese statutory restructuring and insolvency proceedings.

4.3 The Typical Timelines for Enforcing a Secured Claim and Lien/Security

As explained in **4.2 Rights and Remedies for Secured Creditors** above, in bankruptcy proceedings and civil rehabilitation proceedings, a secured creditor is entitled to enforce its security interest at any time outside of the proceedings. The timeline of such enforcement may vary depending on the types of collateral.

In the enforcement of mortgage over real estate, it will typically take six months to one year to complete the statutory sales process by auction. In the pledge or mortgage by transfer over claims or movable property, the secured creditor only needs to notify the enforcement of security interest to pledger or mortgagor, but it may take some time to sell or otherwise collect from such claims or movable property.

In civil rehabilitation proceedings, if there is any creditor holding a security interest over the debtor's property indispensable for the continuation of the debtor's business, such debtor needs to agree with the secured creditor not to enforce the security interest over such property. In such agreement, the debtor and the secured creditor generally agree on the valuation of the property – any claim amount exceeding such agreed valuation of the property will be regarded as general unsecured claim. To enter into such agreement with the secured creditor, the debtor needs to obtain a consent from the supervisor.

In bankruptcy proceedings, the trustee may reach an agreement with the secured creditor to sell the collateral voluntarily (without using the statutory sales process by auction) by agreeing on the amount to be repaid to such secured creditor from the sales proceeds and the amount to be distributed to other creditors in the bankruptcy proceeding.

4.4 Special Procedures or Impediments That Apply to Foreign Secured Creditors

There are no special procedures or impediments that apply to foreign secured creditors.

4.5 Special Procedural Protections and Rights for Secured Creditors

Unlike US Chapter 11 proceedings, in Japan there is no mechanism of special procedural protection for the secured creditors.

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities Among Classes of Secured and Unsecured Creditors

As explained above in **4.2 Rights and Remedies for Secured Creditors**, in civil rehabilitation proceedings and bankruptcy proceedings, a secured creditor can generally enforce its security interest through a foreclosure or sale of the collateral outside of the proceedings. In relation to the proceeds of such foreclosure or sale, a secured creditor will be paid prior to other creditors; if there is any remaining balance of the claim after such repayment, such balance will be treated as an unsecured claim without any priority over other unsecured claims and paid under the proceedings on a pro rata basis.

In contrast, a secured creditor in corporate reorganisation proceedings cannot enforce its security interest outside of the proceedings. The trustee makes the valuation of the collateral based on the present value as of the date of the commencement of the proceeding and the amount of such valuation will be the amount of a secured reorganisation claim of the secured creditor. A secured reorganisation claim will be paid prior to other claims in accordance with the reorganisation plan. If the amount of claim held by a secured creditor exceeds the valuation of the collateral, such excess amount will be treated as a unsecured reorganisation claim without any priority over other unsecured claims and paid in accordance with the reorganisation plan on a pro rata basis.

5.2 Unsecured Trade Creditors

As explained above in **3.1 Consensual and Other Out-of-court Workouts and Restructurings**, unsecured trade creditors are generally paid in full in out-of-court consensual workouts.

In contrast, unsecured trade creditors in statutory insolvency and restructuring proceedings will only get paid in the proceedings on a pro rata basis, in principle.

To maintain the commercial relationship with trade creditors and the value of the debtor's business, in civil rehabilitation proceedings and corporate reorganisation proceedings, the court may exempt payment of the following pre-commencement unsecured claims from prohibition of payment:

- any claims held by a small or medium-sized creditor, if the debtor was the major client of such creditor and such creditor is likely to experience significant hindrance to the continuation of its business unless the claim is paid;
- any small amount claims, if the payment helps the smooth progress of the proceedings; and
- any small amount claims, if significant impairment would be caused to the continuation of the debtor's business without making such payment. The "small amount" may differ depending upon the size of the debtor's business.

5.3 Rights and Remedies of Unsecured Creditors

Unsecured creditors are not allowed to enforce their rights outside the statutory insolvency and restructuring proceedings. In civil rehabilitation proceedings and corporate reorganisation proceedings, unsecured creditors will have a

chance to vote at the creditors' meeting to approve or disapprove a proposed restructuring plan.

The debtor (DIP) or trustee, as applicable, in the civil rehabilitation proceedings and the trustee in the corporate reorganisation proceedings must submit a restructuring plan. In addition, unsecured creditors are entitled to prepare and propose their own restructuring plan, and the court may make an order to refer such plan to a resolution at the creditors' meeting, together with the plan proposed by the debtor/trustee.

5.4 Pre-judgment Attachments

Upon the commencement of statutory insolvency and restructuring proceedings, any compulsory execution, provisional attachment, provisional disposition and compulsory auction based on pre-commencement unsecured claims are prohibited, and any ongoing or pending procedures of such nature are stayed automatically.

5.5 Typical Timeline for Enforcing an Unsecured Claim

In Japan, it is not allowed to enforce an unsecured claim in statutory insolvency and restructuring proceedings.

5.6 Bespoke Rights or Remedies for Landlords

In the case where a bankruptcy proceeding commenced with respect to the lessee, the land lease agreement will be treated as an executory contract, and the bankruptcy trustee of the lessee may elect to perform or cancel the lease agreement. The landlord cannot cancel the lease agreement solely because of the commencement of the bankruptcy proceedings. A similar rule shall apply to the civil rehabilitation and corporate reorganisation proceedings of the lessee.

5.7 Special Procedures or Impediments or Protections That Apply to Foreign Creditors

There are no special procedures or impediments applicable to foreign unsecured creditors. The Bankruptcy Act clarifies that a foreign national or foreign juridical person shall have the same status as a Japanese national or Japanese juridical person, respectively, with respect to bankruptcy proceedings.

5.8 The Statutory Waterfall of Claims

The statutory waterfall of unsecured claims in statutory insolvency and restructuring proceedings is as follows.

Civil Rehabilitation Proceedings:
- common benefit claims (*kyoeki-saiken*);
- general priority claims (*ippan-yusen-saiken*);
- rehabilitation claims (*saisei-saiken*);
- contractually subordinated rehabilitation claims (*yakujo-retsugo-saisei-saiken*).

Please refer to **6.11 Statutory Process for Determining the Value of Claims** below for the meaning of the above class of claims.

Corporate Reorganisation Proceedings:
- common benefit claims (*kyoeki-saiken*);
- secured reorganisation claim (*kosei-tanpoken*);
- unsecured reorganisation claim (*kosei-saiken*);
- contractually subordinated reorganisation claims (*yakujo-retsugo-saisei-saiken*)

Please refer to **6.11 Statutory Process for Determining the Value of Claims** below for the meaning of the above class of claims.

Bankruptcy Proceedings:
- estate claim (*zaidan-saiken*);
- preferred bankruptcy claim (*yusenteki-hasan-saiken*);
- general bankruptcy claim (*hasan-saiken*);
- subordinated bankruptcy claim (*retsugoteki-hasan-saiken*);
- contractually subordinated bankruptcy claim (*yakujo-retsugo-hasan-saiken*).

Please refer to **7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings** below for the meaning of the above class of claims.

5.9 Priority Claims

Under Japanese law, "common benefit claim" in civil rehabilitation proceedings and corporate reorganisation proceedings and "estate claim" in bankruptcy proceedings are entitled to the first priority. Essentially, those claims are expense claims for the common interest of all creditors or for the administration of the debtor's business, assets, or bankruptcy estate. As a general rule, these claims are paid from time to time when due and are payable prior to any other type of claim.

5.10 Priority Over Secured Creditor Claims

As explained in **4.2 Rights and Remedies for Secured Creditors**, in civil rehabilitation proceedings and bankruptcy proceedings, a secured creditor can generally enforce its security interest and get paid outside of the proceedings, in principle. In contrast, a secured creditor in corporate reorganisation proceedings cannot enforce its security interest outside of the proceedings and will get paid only in accordance with the reorganisation plan. Since common benefit claims can be paid from time to time when due and payable, regardless how the reorganisation plan provides, so common benefit claims have priority over a secured creditor's claim.

6. Statutory Restructurings, Rehabilitations and Reorganisations

6.1 The Statutory Process for Reaching and Effectuating a Financial Restructuring/ Reorganisation

As explained above in **2.1 Overview of the Laws and Statutory Regimes**, civil rehabilitation proceedings and corporate reorganisation proceedings can be categorised as the statutory process for reaching and effectuating a financial restructuring/reorganisation. The objective of both proceedings is to enable a debtor to rehabilitate its business operations and restructure its economic activities in accordance with a rehabilitation/reorganisation plan approved by a majority of its creditors.

Commencement of Proceedings

To commence civil rehabilitation proceeding or corporate reorganisation proceeding, a debtor may file a petition for commencement of proceeding if it is likely that a fact constituting the grounds for commencement of bankruptcy proceeding will occur to the debtor, or the debtor is unable to pay its debts as they become due and payable without causing significant hindrance to the continuation of its business.

If the debtor is generally and continuously unable to pay its debts as they become due and payable due to the lack of ability to pay (*shiharai funo*), or the debtor's debts exceed its assets (if the debtor is a company or other legal entity), then the ground for commencement of bankruptcy shall be presumed to exist.

In a civil rehabilitation proceeding, a creditor may file a petition for commencement if it is likely that a fact constituting a ground for commencement of bankruptcy will occur with respect to the debtor. If an insolvency proceeding has been commenced outside of Japan, a representative of the foreign insolvency proceeding (eg, a trustee of such foreign insolvency proceeding) may also file a petition for commencement.

In a corporate reorganisation proceeding, (i) a creditor (or creditors) holding claims equal to 10% or more (in total) of the paid-in capital of the debtor, (ii) a shareholder (or shareholders) holding 10% or more (in total) of the voting rights in the debtor, or (iii) a representative of the foreign insolvency proceeding (eg, a trustee of such foreign insolvency proceeding) may also file a petition if it is likely that a fact constituting a ground for commencement of bankruptcy will occur with respect to the debtor.

Injunction Before a Commencement Order

A stay is not automatically granted upon the filing of a petition for commencement of proceedings, so the debtor or a creditor needs to file a petition for an injunction to preserve the debtor's assets during the period between the filing of the petition and the actual commencement order of proceedings.

The court may, either based on such a petition or in its own discretion, issue a variety of injunction orders, which includes an order restricting (i) debtor's action, such as payment of pre-injunction debts and disposition of the debtor's assets, and (ii) creditor's action, such as taking any step toward a compulsory execution against the debtor's assets.

In civil rehabilitation proceedings, the court may issue the following types of injunctions:

- a temporary restraining order (*Hozen Meirei*), which prohibits:
  (a) payment of pre-injunction debts, and
  (b) disposition of the debtor's assets;
- a stay order (*Chushi Meirei*) – a stay of bankruptcy proceedings against the debtor, compulsory execution against the debtor's property, lawsuit relating to the debtor's property or any other procedure against the debtor or debtor's property;
- a comprehensive prohibition order (*Hokatsuteki Kinshi Meirei*) prohibits creditors from taking any step toward a compulsory execution against the debtor's assets – so far, this injunction has only been granted on an extremely conservative basis;
- a stay order for auction process as means to foreclose a security interest, if the stay benefits the common interest of the creditors and is not likely to cause undue damage to the secured creditor;
- an interim administration order (*Hozen Kanri Meirei*), under which an interim trustee (*Hozen Kanri-nin*) is appointed to administer the debtor's business and property until the commencement order, if a debtor's management or disposition of its property is inappropriate, or if the court finds it necessary for the continuation of the debtor's business; and
- a temporary restraining order for right of avoidance, such as provisional attachment or provisional disposition, to secure the right of avoidance of supervisor after the commencement of the proceedings.

In corporate reorganisation proceedings, the court may issue similar orders (please note that the comprehensive prohibition order would prohibit exercise of security interests) and, in addition, an injunction to extinguish a retention right under the Commercial Code or under the Companies Act (*shoji-ryuchi-ken*), if the subject of the retention right is indispensable for the continuation of the debtor's business.

6.2 Position of the Company During Procedures

Operation of Debtor during Proceedings

In civil rehabilitation proceedings, the management of the debtor generally continues to operate the debtor's business as the DIP.

To supervise such operation of the debtor's business, the court usually appoints a supervisor in its commencement order of the proceeding. Such supervisor appointed by the court is responsible for approving certain of the debtor's transactions, as determined by the court. The supervisor may request the debtor or its directors to report on the status of the debtor's business and property to the supervisor, and the supervisor is also entitled to inspect the debtor's books, documents and any other matters. The supervisor reports the results of the above to the court. In civil rehabilitation proceedings, the court may empower the supervisor to exercise a right of avoidance. For further details about the avoidance, please see section **13 Transfers/Transactions That May Be Set Aside**, below.

If the operation of the debtor's business or the disposition of its property by the debtor's management is inappropriate, or if the court finds it necessary for the continuation of the debtor's business, the court may appoint a trustee (*kanzai-nin*) and the authority of the debtor's management to operate the debtor's business and administer its property will then be taken over by the trustee. The court may also appoint an examiner (*chosa-iin*) to examine certain matters as the court deems necessary and report the result of such examination to the court.

In corporate reorganisation proceeding, the court appoints a trustee in its commencement order of the proceeding, and such trustee has the exclusive power to operate the debtor's business and administer the debtor's assets.

Commencement Order
If the court finds that the requirements for commencement of requested proceeding are met, the court will issue a commencement order, unless:

- expenses for the requested proceeding are not prepaid;
- any other statutory insolvency and restructuring proceeding is pending and such other proceeding conforms to the common interests of the creditors;
- it is obvious that the proposed restructuring plan is unlikely to be prepared by the debtor, approved by creditors or confirmed by the court; or
- the petition is filed for an unjustifiable purpose or not filed in good faith.

A commencement order of civil rehabilitation/corporate reorganisation proceedings has the following effects.

Prohibition of payment of pre-commencement order debts
In principle, upon the commencement of the proceedings, the debtor is prohibited from paying pre-commencement unsecured claims as such unsecured claims may only be paid in accordance with a rehabilitation plan.

In the civil rehabilitation proceedings, the payment and enforcement of secured claims, priority claims and common benefit claims (administrative claims) is allowed even after the commencement of the proceedings. In contrast, in corporate reorganisation proceedings, payment of pre-commencement secured claims is basically prohibited.

Prohibition and stay of compulsory execution, etc
Upon the commencement of the proceedings, any compulsory execution, provisional attachment, provisional disposition and compulsory auction based on pre-commencement unsecured claims are prohibited, and any ongoing or pending procedures of such nature are stayed automatically. Petitions for bankruptcy or special liquidation proceedings are prohibited and any such pending proceedings are stayed or cancelled.

In addition, in corporate reorganisation proceedings, any foreclosure of security interests is prohibited and any ongoing or pending foreclosures are automatically stayed upon the commencement of corporate reorganisation proceedings.

Cessation and assumption of lawsuit
Any lawsuit based on unsecured claims relating to the debtor's assets is automatically stayed upon the commencement of civil rehabilitation proceedings.

6.3 The Roles of Creditors During Procedures

In civil rehabilitation proceeding, the creditors and other interested parties can file a petition for the recognition of an official rehabilitation creditors' committee by the court. In order for the court to recognise the rehabilitation creditors' committee, the majority of the rehabilitation creditors (i) must approve the involvement of the creditors' committee in the proceedings, and (ii) agree that the creditors committee properly represents the interests of all rehabilitation creditors.

In a corporate reorganisation proceeding, the secured reorganisation creditor, unsecured reorganisation creditors and the shareholders of the debtor can file a petition for the recognition of their respective official committee by the court. In order for the court to recognise the committee, the majority of the secured reorganisation creditors, unsecured reorganisation creditors or the shareholders must approve the involvement of their own committee in the proceedings, and agree that the committee properly represents the interests of all secured reorganisation creditors, unsecured reorganisation creditors or shareholders. The number of the committee members should be ten or less.

If a committee has been recognised, the court approves the involvement of the committee in the proceedings. The committee is entitled to (i) receive a report prepared by the debtor regarding the status of its business and assets, (ii) request

the court to issue an order, for the benefit of all creditors, to have the debtor prepare a report regarding debtor's business, assets and revitalisation, and (iii) express its opinion relating to the debtor's business, asset and revitalisation proceeding.

In addition to the formation of the committee, creditors and shareholders may, upon the court's permission, elect one or more representatives.

In practice, it is still rare that a creditors' committee is formed in civil rehabilitation proceedings and corporate reorganisation proceedings in Japan. However, there is a notable case where a secured creditors' committee was formulated and recognised by the court, and achieved full recovery of their underlying claims in the corporate reorganisation proceeding.

6.4 Modification of Claims

In civil rehabilitation proceedings, a creditors' meeting is convened for the purpose of, among other things, reporting the debtor's financial condition and making a resolution regarding the rehabilitation plan. If the rehabilitation plan is approved by the creditors (please see **6.12 Restructuring or Reorganisation Plan or Agreement Among Creditors** below for details), confirmed by the court and the confirmation becomes final, such rehabilitation plan will be binding on dissenting creditors.

In corporate reorganisation proceedings, if the reorganisation plan is approved by the creditors (see **6.12 Restructuring or Reorganisation Plan or Agreement Among Creditors**, below) and confirmed by the court, such reorganisation plan will be binding on dissenting creditors and shareholders.

6.5 Trading of Claims

Claims against a debtor undergoing civil rehabilitation proceedings or corporate reorganisation proceedings can be traded. Any transfer of claim against the debtor shall be notified to the debtor by the transferor. To keep the court's record updated, the transferor shall notify the court as well.

6.6 Using a Restructuring Procedure to Reorganise a Corporate Group

Civil rehabilitation proceedings or corporate reorganisation proceedings can be utilised for restructuring of group companies. The companies must file for the proceedings respectively, and sometimes the plan provides for a merger of the group companies.

6.7 Restrictions on the Company's Use of or Sale of Its Assets During a Formal Restructuring Process

The objective of civil rehabilitation proceedings and corporate reorganisation proceedings is to enable a debtor to rehabilitate its business operations and restructure its economic activities, so that the debtor may continue its business activities, and use and sell its assets during the restructuring process. The court's permission, or consent of the supervisor (if appointed), is required for certain important matters. For the sale of a debtor's business, please see **6.8 Asset Disposition and Related Procedures,** below.

6.8 Asset Disposition and Related Procedures

In civil rehabilitation proceedings, the debtor may assign all or a substantial portion of its business in accordance with the rehabilitation plan.

In addition, if such assignment is necessary for the successful rehabilitation of the debtor's business, the debtor may assign the business outside the plan upon the court's approval.

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the debtor has pre-negotiated with a potential buyer prior to the commencement of proceedings, the debtor may effectuate the deal by obtaining the court's approval.

The Companies Act normally requires a special resolution of the shareholders' meeting that approves an assignment of all or a substantial portion of its business. However, the debtor may be exempt from this requirement if the amount of its debts exceeds the amount of assets and the court approves the application of the exemption.

The court has to hold a hearing to obtain the creditors' views before the court determines to approve/disapprove an assignment of all or a substantial portion of the debtor's business outside the plan.

Similar to civil rehabilitation proceedings, under the corporate reorganisation proceedings, the trustee may assign all or a substantial portion of the debtor's business outside the reorganisation plan upon the court's permission, if such assignment is necessary for the successful restructuring of the debtor's business.

If the debtor's total debts do not exceed the total value of its assets, the court may not approve such assignment if more than one-third of shareholders oppose the assignment. However, in practice, almost all debtors' debt exceeds its assets, so obtaining the shareholders' opinion is usually not required.

6.9 Release of Secured Creditor Liens and Security Arrangements

In civil rehabilitation proceedings, as a general rule, a secured creditor can enforce its security interest through a foreclosure or sale of the collateral outside of the civil rehabilitation proceedings. If a claim is not paid in full through such foreclosure or sale, the remaining balance of the claim is treated as an unsecured claim under the civil rehabilitation proceedings. Notwithstanding the above, the debtor is, subject to approval from the court, entitled to extinguish a

security interest over the debtor's property, if such property is vital for the rehabilitation of the debtor.

6.10 Availability of Priority New Money

DIP financing is common in Japan. DIP financing after the filing for civil rehabilitation proceedings or corporate reorganisation proceedings will be regarded as common benefit claims (administrative claims).

6.11 Statutory Process for Determining the Value of Claims

Civil Rehabilitation Proceedings

Rehabilitation claims (Saisei Saiken)

A claim that arose from a cause that occurred before the commencement of the civil rehabilitation proceedings is classified as a rehabilitation claim (general unsecured claim). As explained above, payment of a pre-commencement unsecured claim (ie, a rehabilitation claim) is generally prohibited upon the commencement of civil rehabilitation proceedings, and a rehabilitation claim only can be paid in accordance with a rehabilitation plan.

Filing proofs of claims

Payment of a pre-commencement unsecured claim (a rehabilitation claim) is generally prohibited after the commencement of the civil rehabilitation proceedings, and such a claim can only be paid in accordance with a rehabilitation plan. To be eligible for voting in the approval of a rehabilitation plan and payment under the plan, a creditor who has rehabilitation claims must file a proof of its claim within the period for filing proofs prescribed by the court. A secured creditor whose claim is not fully covered by the security interest must also make a filing for the amount of the claim expected to exceed the value of the collateral.

Investigation and determination of claims

With respect to any proof of claim duly filed, the debtor is to prepare and file with the court a schedule that indicates whether the debtor approves or disapproves the content of such claim and the voting right of the relevant creditor ("the schedule of claim approval/disapproval"). If the debtor is aware of any rehabilitation claim, for which no proof has been filed, the debtor must indicate in the schedule whether it approves or disapproves such claim.

Any creditor who has filed a proof of claim is entitled to object to a claim indicated in the schedule of claim approval/disapproval during the period prescribed by the court. A claim that is approved by the debtor and is not objected to by any creditor is considered final. A court clerk inserts all final claims in the schedule of creditors. The entry of claims into that schedule has the same effect as a final and binding judgment with respect to the finalised claims.

If the debtor or any creditor objects to a proof of any claim, such claim will be assessed by the court. A creditor whose claim is objected to may file a petition for assessment of the existence or the amount of the claim in a fast-track proceeding. A party who disagrees with the court's decision regarding a claim assessment can file a lawsuit within one month of its receipt of the court's decision.

Corporate reorganisation proceedings

secured reorganisation claims (kosei tanpoken)

A claim that arose from a cause that occurred before the commencement of the corporate reorganisation proceedings, and that is secured by a security interest over the debtor's property, is classified as secured reorganisation claims.

As explained above, payment of a secured reorganisation claim is prohibited upon the commencement of the corporate reorganisation proceedings (and even before the commencement, prohibited by the comprehensive prohibition order, if issued by the court), and a secured reorganisation claim can be paid only in accordance with the reorganisation plan.

The trustee makes the valuation of the collateral based on the present value as of the date of the commencement of the proceedings. To the extent a claim exceeds the value of the collateral, the exceeding part (the deficiency claims) is dealt with as a general unsecured claim (ie, unsecured reorganisation claim). The holder of a secured reorganisation claim has the right to challenge the trustee's valuation of the collateral.

Upon a petition from the trustee, the court may extinguish a security interest over the debtor's asset, if the court finds it necessary for the reorganisation of the debtor's business. In the petition to the court, trustee should specify the collateral, its value and the security interest to be extinguished, and should deposit with the court an amount in cash equivalent to the value of the collateral. If disputed, the value will finally be determined by the court.

Unsecured reorganisation claims (kosei saiken)

A claim that arose from a cause that occurred before the commencement of the corporate reorganisation proceedings (excluding claims classified as a common benefit claims or secured reorganisation claims) is classified as an unsecured reorganisation claim. As explained above, payment of an unsecured reorganisation claim is prohibited upon the commencement of the corporate reorganisation proceedings, and an unsecured reorganisation claim can be paid only in accordance with a reorganisation plan.

Any unsecured reorganisation claim that is secured by a general statutory lien (*ippan no sakidori tokken*) or has any other general priority (*ippan no yusenken*) under the relevant law is prioritised over general unsecured reorganisation claims.

Filing proofs of claims
Under corporate reorganisation proceedings, both secured creditors and unsecured creditors must file a proof of their claim within the period for filing proofs prescribed by the court. The procedures for filing proofs, investigation and determination of claims are similar to those under civil rehabilitation proceedings.

With respect to the secured claims, the creditors must file the value of the collateral, in addition to the amount of the actual claim. Any amount of the claim exceeding the value of the collateral will be treated as an unsecured claim.

Investigation and determination of claims
If the trustee and/or any creditor object to a secured claim, the holder of such secured claim may file a request for valuation of the collateral. The court then determines the value of the collateral, taking into account the valuation made by a court-appointed appraiser, in a fast-track proceeding.

6.12 Restructuring or Reorganisation Plan or Agreement Among Creditors

Civil Rehabilitation Proceedings

Terms of a rehabilitation plan
The debtor must propose a rehabilitation plan and submit it to the court within the period prescribed by the court. A creditor who filed a proof of claims may also file a rehabilitation plan within the period prescribed by the court.

A rehabilitation plan should address amendment of rehabilitation claims, such as reduction or release of debts or extension of the terms of debts. As a general rule, such amendment must be applied equally to all rehabilitation claims.

The distribution rate varies from case to case, depending on the size of the estate and the value of the debtor's business, but shall exceed the distribution rate calculated based on the assumption that the debtor was in bankruptcy proceedings.

A rehabilitation plan may provide for reduction of shareholders' equity interests without observing the procedures required under the Companies Act (eg, approval at a shareholders' meeting), if the debtor's debts exceed its assets and the debtor obtains court approval. Besides the reduction of shareholders' equity interests, a rehabilitation plan submitted by the debtor may also provide that the debtor should issue new shares to a third party without the approval at the shareholders' meeting.

Approval and confirmation of a rehabilitation plan
A proposed rehabilitation plan may be voted by document or at a creditors' meeting. Approval of the proposed plan requires (i) an affirmative vote by a simple majority of voting right holders voted by document or at the creditors' meeting, and (ii) an affirmative vote by voting right holders who holds 50% or more (in total) of the total amount of voting rights held by all creditors.

When the proposed rehabilitation plan is approved, the court issues an order of confirmation of the approved rehabilitation plan, unless the court shall make an order of disconfirmation as prescribed under the Civil Rehabilitation Act (eg, the plan is unlikely to be executed, the plan is contrary to the common interest of the rehabilitation creditors, etc). The confirmed plan becomes effective upon the confirmation order becoming final and binding and creditors' rights under the plan will be deemed to be a claim confirmed by a final and binding judgment.

Corporate Reorganisation Proceedings

Terms of a reorganisation plan
A reorganisation plan provides for the treatment of different types of rights, such as secured reorganisation claims, unsecured reorganisation claims and stocks. Among such different types of rights, a fair and equitable difference in the treatment must be provided. All persons holding the same type of right shall be treated equally under a reorganisation plan. In general, claims and interests are categorised and treated in the following manner in the reorganisation plan:

- secured reorganisation claims – the distribution rate is usually 100%, provided, however, that any interest accrued more than one year after the commencement of the proceedings is treated as a general unsecured reorganisation claim;
- preferred unsecured reorganisation claims – the distribution rate is usually 100%;
- general unsecured reorganisation claims – the distribution rate varies from case to case, depending on the size of the estate and the value of the debtor's business, but shall exceed the distribution rate calculated based on the assumption that the debtor was in bankruptcy proceedings;
- contractual subordinated unsecured reorganisation claims and post-commencement claims – no distribution in most cases; and
- stocks – usually cancelled without compensation.

The payments may be made by installments for a period of no longer than 15 years (20 years if there are special reasons). However, in most cases the reorganisation trustee tries to find a viable "sponsor" (ie, acquirer) to maintain the reorganisation company's business; if the sponsor is found, a reorganisation plan usually provides much shorter, or one-shot, payment terms.

A reorganisation plan may, in a more flexible way than a rehabilitation plan, provide for amendments of the shareholders' rights or the capital structure, such as a reduction of capital and issuance of new shares to a third party or an acquisition, without observing the procedures required under the Companies Act.

Approval and confirmation of a reorganisation plan
The trustee must propose a reorganisation plan and submit it to the court within a period of one year or less from the commencement of the proceeding, as prescribed by the court (the period may be extended). The debtor, any secured and unsecured reorganisation creditor, and any shareholder may also propose and submit a reorganisation plan by the period prescribed by the court. Recently, creditors sometimes submit their own reorganisation plan in an attempt to obtain more favourable terms and conditions from the trustee.

The plan is voted on by each class of stakeholders either at a creditors' meeting or by document. If the debtor's debts exceed its assets, shareholders do not have the right to vote on a reorganisation plan. In practice, since almost all debtors' debts exceed the assets, shareholders do not have the right to vote. Normally, the plan provides for only two classes of stakeholders: (i) all the secured reorganisation creditors, and (ii) all the unsecured reorganisation creditors.

The requirements for approval of the reorganisation plan by each class of stakeholders are as follows:

- unsecured reorganisation creditors – an affirmative vote by the unsecured reorganisation creditors who hold 50% or more (in total) of the total amount of voting rights held by the unsecured reorganisation creditors;
- secured reorganisation creditors – (i) if the proposed reorganisation plan provides for deferment of payments, an affirmative vote by the secured reorganisation creditors who hold two-thirds or more (in total) of the total amount of voting rights held by the secured reorganisation creditors, (ii) if the proposed reorganisation plan provides for discharge of the secured reorganisation claims or any other provisions that affect the secured reorganisation claims other than deferment of payments, an affirmative vote by the secured reorganisation creditors who hold three-quarters or more (in total) of the total amount of voting rights held by the secured reorganisation creditors, and (iii) if the proposed reorganisation plan provides for the discontinuation of entire business of the debtor, an affirmative vote by the secured reorganisation creditors who hold nine-tenths or more (in total) of the total amount of voting rights held by the secured reorganisation creditors; and
- shareholders – an affirmative vote by the shareholders holding a majority of the voting rights (however, shareholders usually do not have the right to vote because almost all debtors' debts exceed its assets).

If the required affirmative votes are not obtained by one of the classes, the court may amend the reorganisation plan to protect such class of stakeholders as follows and confirm the reorganisation plan:

- with respect to secured reorganisation creditors, to keep the security interest as is to secure the secured reorganisation claim, or pay the secured reorganisation claim with the net sales proceeds of the sale of the collateral at the court-determined fair market value (as evaluated free and clear of the security interest) or higher price;
- with respect to unsecured reorganisation creditors, to pay an amount equivalent to the distribution expected in the bankruptcy proceedings; and
- with respect to any person who holds other type of rights, to pay a fair market value of the right as determined by the court.

6.13 The Ability to Reject or Disclaim Contracts

If neither the debtor nor the counterparty has completed their respective obligations under a bilateral executory contract at the time of the commencement of the proceedings, the trustee (or DIP under the civil rehabilitation) may choose to either cancel or perform the contract. If it is chosen to perform the contract, the counterparty's right under the contract becomes a common benefit claim, which means that the counterparty will be entitled to full payment. If it is chosen to cancel the contract, the counterparty may request that whatever it has delivered to the debtor be returned, and if it has been lost, the counterparty has a common benefit claim for its value. However, the counterparty's right to damages caused by such cancellation is considered as a pre-commencement unsecured claim.

Notwithstanding the above rule, in the case of bankruptcy, civil rehabilitation or corporate reorganisation proceedings commenced with respect to a lessor or licensor, the lease contract or licence agreement may not be cancelled by the trustee (or DIP under the civil rehabilitation) of the lessor or licensor, if the right of the lessee or licensee (right to lease or license) is perfected by registration or similar.

6.14 Creditors' Rights of Set-off, Off-set or Netting

In civil rehabilitation proceedings and corporate reorganisation proceedings, a creditor who owes a debt to the debtor at the time of the commencement of the proceedings may offset its claim against the debtor even after the commencement of the proceedings if (i) both the claim and the debt exist as of the date of the commencement of the proceedings, (ii) both the claim and the debt become due before the expiry of the period for filing proof of claims, and (iii) the right to set-off is exercised before the expiration of such period.

Set-off by a creditor is prohibited in the following cases:

(i) the creditor has assumed a debt to the debtor after the commencement of the proceedings;

(ii) the creditor has assumed a debt to the debtor after the debtor became generally and continuously unable to pay its debts as they become due and payable due to the lack of ability to pay (*shiharai funo*) by concluding a contract for (x) disposing of the debtor's property with the sole intention

to set off any debt to be assumed by the creditor under the contract against its pre-commencement claims against the debtor, or (y) assuming any debt owed by another person to the debtor, and the creditor knew that the debtor was unable to pay debts at the time of conclusion of the contract;

- (iii) the creditor has assumed a debt to the debtor after the debtor has suspended its payments, with knowledge of such suspension, except if the debtor was able to pay its debts despite the suspension; or
- (iv) the creditor has assumed a debt to the debtor after a petition for civil rehabilitation proceedings, corporate reorganisation proceedings, bankruptcy proceedings or special liquidation regarding the debtor has been filed, with knowledge of such filing.

Similarly to the restrictions of set-off by a creditor, set-off by a person who owes a debt to the debtor is prohibited under the following cases:

- (v) the person has acquired a pre-commencement claim against the debtor after the commencement of the proceedings;
- (vi) the person has acquired a pre-commencement claim against the debtor after the debtor became generally and continuously unable to pay its debts as they become due and payable due to the lack of ability to pay (*shiharai funo*), and the person knew that the debtor was unable to pay its debts at the time of the acquisition of the claim;
- (vii) the person has acquired a pre-commencement claim against the debtor after the debtor suspended its payments, with knowledge of such suspension, except if the debtor was able to pay debts despite of the suspension; or
- (viii) the person has acquired a pre-commencement claim against the debtor after a petition for civil rehabilitation proceedings, corporate reorganisation proceedings, bankruptcy proceedings or special liquidation regarding the debtor has been filed, with knowledge of such filing.

Notwithstanding what is set out in items (ii) to (iv) and (vi) to (viii), set-off is permitted if the debt or claim was assumed or acquired due to any of the following causes:

- a statutory cause;
- a cause that had occurred before the creditor became aware of the debtor's inability to pay its debts, the debtor's suspension of payments or the filing of a petition for insolvency proceedings (regarding items (ii) to (iv));
- a cause that had occurred before the person became aware of the debtor's inability to pay its debts, the debtor's suspension of payments or the filing of a petition for insolvency proceedings (regarding items (vi) to (viii));
- a cause that had occurred not less than one year before the filing of a petition for any statutory insolvency and restructuring proceedings (regarding items (ii) to (iv) and (vi) to (viii)); or
- a contract concluded between the debtor and the person who owes a debt to the debtor (regarding the preceding cases of (vi) to (viii)).

6.15 Failure to Observe the Terms of an Agreed Restructuring Plan

If it has become obvious that the rehabilitation/reorganisation plan is unlikely to be performed after an order of confirmation of the rehabilitation plan/reorganisation has become final and binding, the court shall make an order of discontinuance of rehabilitation/reorganisation proceedings. After such order of discontinuance, the court may make an order of commencement of bankruptcy proceedings by its own authority, when it finds that a fact constituting the grounds for commencement of bankruptcy proceedings exists with regard to such debtor.

6.16 Receive or Retain Any Ownership or Other Property

As a general rule, existing shareholders will continue to keep their equity interests in the debtor even after the commencement of proceedings.

In civil rehabilitation proceedings, shareholders have no right to vote for or against the rehabilitation plan. A rehabilitation plan may provide for reduction of shareholders' equity interests without observing the procedures required under the Companies Act (eg, approval at a shareholders' meeting), if the debtor's debts exceed its assets and the debtor obtains court approval. Besides the reduction of shareholders' equity interests, a rehabilitation plan submitted by the debtor may also provide that the debtor should issue new shares to a third party without the approval at the shareholders' meeting.

In corporate reorganisation proceedings, when the debtor's total debts exceed its assets at the time of the commencement of the corporate reorganisation proceedings, shareholders have no right to vote for or against the reorganisation plan.

A reorganisation plan may, in a more flexible way than a rehabilitation plan, provide for amendments of the shareholders' rights or the capital structure, such as a reduction of capital and issuance of new shares to a third party or an acquisition, without observing the procedures required under the Companies Act.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings

As explained above in **2.1 Overview of the Laws and Statutory Regimes**, the objective of bankruptcy proceedings is to liquidate all of the debtor's assets into cash and distribute it

among creditors on a pro rata basis depending on the priority of claims.

Commencement of Proceedings
To commence bankruptcy proceedings, a debtor, a director of a debtor (if a debtor is a company), a creditor or a representative of the foreign insolvency proceeding (eg, a trustee of such foreign insolvency proceeding), etc, may file a petition to commence bankruptcy proceedings if (i) the debtor is generally and continuously unable to pay its debts as they become due and payable due to the lack of ability to pay (*shiharai funo*), or (ii) the debtor's debts exceed its assets (if the debtor is a company or other legal entity).

If a court confirms that the requirements for the commencement of bankruptcy proceedings have been met, the court will issue the commencement order unless (i) expenses for the proceedings have not been prepaid, (ii) the petition is filed for an unfair purpose or it is not filed in good faith, or (iii) other insolvency proceedings are pending. In the commencement order of bankruptcy, which is published by public notice, the date and time of such order are indicated, which makes it clear when the commencement order takes effect.

Injunction Before a Commencement Order
In bankruptcy proceedings, there is no automatic stay granted by the filing of a petition for commencement of the proceedings. There are injunctions available to preserve the debtor's assets during the interim period between the filing of a petition and the commencement order of bankruptcy proceedings, but usually they are not used in practice.

Position of the Company During Procedures
Upon the issuance of the commencement order, a bankruptcy trustee, usually selected from a lawyer with appropriate experience and expertise in insolvency practice, is appointed by the court.

Upon commencement of bankruptcy proceedings, the debtor loses the power to administer and dispose of its assets. Debtor's assets as of commencement of bankruptcy proceedings constitute the "bankruptcy estate" and the power to administer and dispose of the bankruptcy estate is vested exclusively in the bankruptcy trustee.

The bankruptcy trustee is required to endeavour to maintain or increase the size of the bankruptcy estate, and convert the bankruptcy estate into cash for distribution to creditors.

Claim Filing and Distributions
Category of claims
Creditors holding bankruptcy claims must file a proof of claim in order to receive a distribution from the bankruptcy estate. Bankruptcy claims are classified and accorded priority as follows:

- preferred bankruptcy claims (*Yusenteki Hasan Saiken*) include, among others, (i) employee claims incurred prior to the commencement of bankruptcy proceedings (excluding claims classified as administrative expenses), and (ii) tax claims that have arisen prior to the commencement of bankruptcy proceedings (excluding claims classified as administrative expenses);
- general bankruptcy claims (*Hasan Saiken*) – borrowing, trade and other claims without priority are classified as a general bankruptcy claim;
- subordinated bankruptcy claims (*Retsugoteki Hasan Saiken*) include, among others, (i) interest, default interest and penalties incurred after the commencement of bankruptcy proceedings, and (ii) overdue tax incurred after the commencement of bankruptcy proceedings; and
- contractually subordinated bankruptcy claims (*Yakujo Retsugo Hasan Saiken*) are the claims contractually agreed to be subordinated to a subordinated bankruptcy claim. The contractually subordinated bankruptcy claim can be paid after all subordinated bankruptcy claims have been paid.

Filing and Examination of Claims
Creditors holding bankruptcy claims must file a proof of claim with the court. Similar to civil rehabilitation proceedings, secured creditors whose claim is not fully covered by the security interest will be treated as bankruptcy claim holders and must file the expected amount of claims to be unsecured.

Each claim is examined by the bankruptcy trustee and any creditor. Usually, a claim investigation hearing is held on the same day as, and immediately following, the first creditors' meeting. The investigation and determination of claims in bankruptcy proceedings are almost the same as those in civil rehabilitation proceedings and corporate reorganisation proceedings. Please see above, **6.11 Statutory Process for Determining the Value of Claims** regarding civil rehabilitation.

Distributions
When assets of the bankruptcy estate have been liquidated into an appropriate amount of cash for distribution, distributions are made to creditors in accordance with the priority. A secured creditor is not entitled to receive distributions and is excluded from distribution unless it proves the claim amount that became unsecured after the commencement of bankruptcy proceedings, or the amount of deficiency after foreclosure. Notwithstanding the above, with respect to a creditor with a revolving mortgage, the amount exceeding the prescribed maximum limit of the security facility is, even if the deficiency amount cannot be proven, deemed to be the deficiency amount.

Right of recovery
An owner of a property that is held by the bankruptcy trustee as a part of the bankruptcy estate may make a claim for return of the property.

Security interests
Similar to civil rehabilitation proceedings, a secured creditor who has a security interest over the property in the bankruptcy estate may exercise the security interest through a foreclosure or sale of the collateral outside bankruptcy proceedings.

Notwithstanding the above, the bankruptcy trustee may file a petition to the court to extinguish such security interest if it better serves the creditor's general interests to sell the property free and clear from the security interest. The bankruptcy trustee is required to clarify in the petition the amount of sales proceeds and the amount to be carved out from the sales amount to the bankruptcy estate. The creditor with the security interest over the property is, in contesting the proposed extinction of the security interest, entitled either (i) to foreclose the security interest, or (ii) to make an offer to purchase, by itself or any other person, the property at an amount not less than 105% of the sales proceeds offered by the bankruptcy trustee.

Set-off
A creditor who owes a debt to the debtor at the time of commencement of bankruptcy proceedings is entitled to set-off its claim against such debt.

Cases in which set-off is prohibited under bankruptcy proceedings are almost the same as those under civil rehabilitation proceedings and corporate reorganisation proceedings. Please see above, **6.15 Failure to Observe the Terms of an Agreed Restructuring Plan** for such prohibited set-off.

7.2 Distressed Disposals as Part of Insolvency/ Liquidation Proceedings
In bankruptcy proceedings, the bankruptcy trustee, who has the power to administer and dispose of the bankruptcy estate, may sell and dispose of the debtor's assets. In the case where the target asset is encumbered by security interest, practically, it is necessary to obtain release of the collateral from the secured creditor (the asset will not be free and clear of the security interest automatically by the sale).

7.3 Implications of Failure to Observe the Terms of an Agreed or Statutory Plan
Bankruptcy proceedings will terminate after final distribution and the creditors' meeting to report the accounts and obtain the termination order of the court. The creditors' meeting to report the accounts may be substituted with a written report to the court. Bankruptcy proceedings will also terminate when (i) all creditors filed proofs agreeing to the termination or (ii) the value of the bankruptcy estate is smaller than the amount of administrative expenses. Upon termination of bankruptcy proceedings, a bankrupt company is generally dissolved.

7.4 Investment or Loan of Priority New Money
Since the objective of bankruptcy proceedings is to liquidate all of the debtor's assets into cash and distribute the cash among creditors, it is rare to provide new money.

7.5 Organisation of Creditors
Similar to civil rehabilitation proceedings and corporate reorganisation proceedings, the bankruptcy creditors can file a petition for the recognition of an official committee by the court. However, to date, there seems to be no precedent of recognition of the committee in bankruptcy proceedings.

8. International/Cross-border Issues and Processes

8.1 Recognition or Other Relief in Connection with Foreign Restructuring or Insolvency Proceedings
Taking account of the UNCITRAL Model Law on Cross-Border Insolvency, Japan enacted the Act on Recognition of and Assistance for Foreign Insolvency Proceedings (the "Recognition Act") in 2001, which sets out measures to extend foreign insolvency proceedings to the debtor's assets in Japan.

As of 30 June 2017, there have been 15 foreign insolvency proceedings to date that have been recognised by the Tokyo District Court under the Act.

Under the Recognition Act, foreign insolvency proceedings may, upon a petition by a representative of a foreign insolvency proceeding (a foreign trustee, or a debtor where no trustee is appointed, etc), be recognised in Japan, if prescribed requirements are met with respect to such proceedings. Under the Recognition Act, with respect to a specific debtor, only one insolvency proceeding is recognised in Japan at the same time in order to avoid complicated and difficult issues arising due to recognition of insolvency proceedings in several jurisdiction.

A representative of a foreign insolvency proceeding may file a petition for recognition of a foreign insolvency proceeding if: (i) a debtor has a domicile, residence, business office or other office in a foreign jurisdiction where a foreign insolvency proceeding is petitioned against the debtor; and (ii) such foreign insolvency proceeding is similar to bankruptcy, civil rehabilitation or corporate reorganisation proceedings in Japan. A foreign representative may file a petition for recognition of a foreign insolvency proceeding even prior to commencement of such foreign insolvency proceeding.

Where the court confirms that the above-mentioned requirements for recognition have been met and commencement of the foreign insolvency proceedings has been formally ordered, the court will issue an order of recognition of the foreign insolvency proceedings unless it finds any of the following:

- the expenses for recognition and assistance proceedings are not prepaid;
- it is obvious that the effect of the foreign insolvency proceedings does not extend to the debtor's property in Japan;
- it is contrary to public policy in Japan to provide assistance for the foreign insolvency proceedings;
- it is obviously unnecessary to provide assistance for the foreign insolvency proceedings under the Recognition Act;
- the foreign representative has failed to report to the court in regard to the status of the development of the foreign insolvency proceeding, except where such violation is minor; or
- it is obvious that the petition was filed for an unfair purpose or it is not filed in good faith.

Since an order of recognition does not grant any automatic effects, such as a stay of execution against the debtor's assets, merely by obtaining recognition, the foreign representative must file a petition for appropriate assistance on a case-by-case basis, and obtain a court order for such assistance.

Where the court issues an order of recognition, upon a petition by an interested person or by the court's own discretion, the court may issue, if necessary, an order of assistance including:

- a temporary suspension order against a compulsory execution proceeding upon judgment, provisional attachment or other injunction, lawsuit, or administrative proceeding, with regard to the debtors' assets in Japan;
- a cancellation order against compulsory execution proceedings, whereby the proceedings may be cancelled depending upon necessity;
- a temporary suspension order against an auction proceeding in foreclosure of a lien;
- a prohibition order against compulsory execution, prohibiting all creditors from enforcing compulsory execution, etc, against the debtor's property;
- an injunction prohibiting the debtor from disposing of assets and making payments;
- an administration order to the effect that the debtors' business and assets within Japan will be administered by a recognised trustee – when the order is issued, the power and authority to manage the debtor's business and to dispose of its assets within Japan, shall be exclusively vested in the recognised trustee; and
- a provisional administration order, when there is an emergency necessity. The provisional administration order grants power and authority to the interim trustee exclusively with regard to the business and assets of the debtor within Japan. This order may be granted only where the order is specifically required to attain the goal of recognition and assistance under the Recognition Act. The interim trustee is required to obtain a specific court order whenever it wishes to conduct any transaction that is out of the ordinary course of business.

8.2 Protocols or Other Arrangements with Foreign Courts

It is not known whether the Japanese courts entered into protocols or other arrangements with foreign courts in any cases. Even for a debtor in insolvency proceedings, it is rare to see such debtor enter into protocols or other arrangements with foreign relevant parties.

8.3 Rules, Standards and Guidelines to Determine the Paramountcy of Law

The Act has adopted the principle that a debtor shall be subject to only one insolvency proceeding. Thus, when there is a conflict between a recognised foreign insolvency proceeding under the Act, a local insolvency proceeding and the petitions for such proceedings with regard to a debtor, such conflict shall be handled in accordance with the following four principles.

A local insolvency proceeding shall, in general, prevail over a recognised foreign insolvency proceeding.

In the case where (i) the recognised foreign insolvency proceeding is the "primary foreign proceeding", (ii) providing assistance to such foreign insolvency proceeding conforms to the general interests of creditors and (iii) providing assistance to such foreign insolvency proceeding will not unduly impair the interests of creditors within Japan, the recognised foreign insolvency proceeding shall prevail over the local insolvency proceeding. A "primary foreign proceeding" means, in the case of a commercial debtor, the foreign insolvency proceeding referred to in the petition for recognition under the Act as the proceeding in the place where the debtor holds its main office of business.

A recognised foreign insolvency proceeding with respect to a primary foreign proceeding shall prevail over those with respect to a non-primary foreign proceeding.

Between or among non-primary foreign proceedings, the one that conforms to the general interests of creditors shall prevail over the others.

8.4 Foreign Creditors

In principle, there is no special treatment for foreign creditors, except for the adoption of the "hotchpot rule". In civil rehabilitation proceedings, corporate reorganisation proceedings and bankruptcy proceedings, any recovery of a creditor, obtained by the exercise of its rights, from the debt-

or's assets located outside of Japan shall be credited against payment under the proceeding in Japan.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers Appointed in Proceedings

Civil Rehabilitation Proceedings

The management of the debtor generally continues to operate the debtor's business as the DIP.

To supervise the management, the court usually appoints a supervisor (*kantoku iin*) who is responsible for approving certain of the debtor's transactions, as determined by the court. In addition, the court may appoint an examiner (*chosa iin*). If the court finds it necessary, sometimes the trustee (*kanzai nin*) is appointed by the court, in which case the management will no longer have the power to manage the debtor's business and assets.

Corporate Reorganisation Proceedings

In the commencement order, the court appoints a reorganisation trustee, usually from lawyers with appropriate experience and expertise in insolvency practice. The court may appoint the management of the debtor to a reorganisation trustee (quasi-DIP type reorganisation proceedings).

Traditionally, to cover the period between the petition for and the commencement of the proceeding, the court often appoints an interim trustee (*hozen kanri nin*); however, recently, in most cases of quasi-DIP type proceedings, such an interim trustee is not appointed.

In addition, the court may appoint an examiner (*chosa iin*).

Bankruptcy Proceedings

Upon commencement of the bankruptcy proceedings, a bankruptcy trustee is appointed by the court, usually from practicing attorneys with appropriate experience and expertise in insolvency practice.

9.2 Statutory Roles, Rights and Responsibilities of Officers

Civil Rehabilitation Proceedings

A supervisor is responsible for approving certain of the debtor's transactions, as determined by the court. The supervisor may request the debtor or its directors to report on the status of the debtor's business and property to the supervisor, and the supervisor is also entitled to inspect the debtor's books, documents and any other matters. The supervisor reports the results of the above to the court. The court may empower the supervisor to exercise a right of avoidance. Please see section **13 Transfers/Transactions That May Be Set Aside** for the details of avoidance.

The court may appoint an examiner to inspect certain matters as determined by the court and report the result of such examination to the court.

The court may appoint an interim trustee before the commencement order, or a trustee after the commencement order, if a corporate debtor's management or disposition of its property is inappropriate, or if the court finds it necessary for the continuation of the debtor's business. The authority of the debtor's management to operate the debtor's business and administer its property will then be taken over by the interim trustee or the trustee.

Corporate Reorganisation Proceedings

A reorganisation trustee has the exclusive power to administer and dispose of the debtor's assets and to operate the debtor's business. A reorganisation trustee also has a power to exercise a right of avoidance. Please see section **13 Transfers/Transactions That May Be Set Aside** for the details of avoidance.

An interim trustee has the power to administer the debtor's business and assets during the period between the petition for and the commencement of the proceeding.

An examiner has the power to examine certain prescribed matters, including the requirements for the commencement of the corporate reorganisation proceeding. The court may also appoint an examiner to investigate the appropriateness of any reports on the financial affairs of the debtor or the reorganisation plan that the trustee proposes and submits to the court. In practice, an examiner is appointed in the case of an involuntary filing by the creditors or when the court appoints the debtor's management as the interim trustee or the trustee of the debtor.

Bankruptcy Proceedings

A bankruptcy trustee has the exclusive power to administer and dispose of the bankruptcy estate. A bankruptcy trustee also has a power to exercise a right of avoidance. Please see section **13 Transfers/Transactions That May Be Set Aside** for the details of avoidance.

9.3 Selection of Statutory Officers

Please see **9.1 Types of Statutory Officers Appointed in Proceedings** and **9.2 Statutory Roles, Rights and Responsibilities of Officers** above for the details of statutory officers.

9.4 Restrictions on Serving as a Statutory Officer

There is no statutory restriction for a creditor, or a representative, owner, officer or director of a creditor to serve as a statutory officer, but it is rare for such a person to be appointed as a statutory officer by the court.

As explained above, statutory officers are generally selected from restructuring professionals, mainly attorneys with appropriate experience and expertise in insolvency practice.

10. Mediations/Arbitrations

10.1 Use of Arbitration/Mediation in Restructuring/Insolvency Matters

There is a special mediation procedure by the court, and it is sometimes used for the purpose of (i) dealing with insolvency of SMEs, or (ii) making an amicable settlement between the debtor and some of the target creditors of the out-of-court workout when they do not give consent to the proposed plan.

11. Duties and Personal Liability of Directors and Officers of Financially Troubled Companies

11.1 Duties of Officers and Directors of a Financially Distressed or Insolvent Company

As discussed above in **2.3 Obligation to Commence Formal Insolvency Proceedings**, under Japanese law, companies and directors thereof are not statutorily obligated to file for formal insolvency proceedings even when they become insolvent. However, under certain circumstances, directors of an insolvent company are held to owe a duty of care to consider filing for formal insolvency proceedings for the purpose of mitigation of the creditors' losses.

12. Transfers/Transactions That May Be Set Aside

12.1 Grounds to Set Aside/Annul Transactions

In civil rehabilitation proceedings, a supervisor is entitled to exercise the right of avoidance if an act is found to be either fraudulent conveyance or granting a preference to a specific creditor, as explained below. A reorganisation trustee in corporate reorganisation proceedings and a bankruptcy trustee in bankruptcy proceedings are also entitled to exercise the right of avoidance in the same manner.

Fraudulent Conveyance

Any of the following transactions, except for the creation of a lien interest and extinction of debt, is voidable:

- both the debtor and the beneficiary entered into the transaction with knowledge that it impaired the interests of other creditors, except where the beneficiary was unaware of the fact that the transaction impaired other creditors;
- the debtor entered into a transaction that impaired the interests of the creditors, after (i) occurrence of cessation of payments or (ii) filing of a petition for any of the insolvency proceedings, except where the beneficiary was unaware of both the occurrence of (i) or (ii) and the fact that the transaction impaired other creditors.

In the event that the debtor entered into a transaction that extinguishes the debt, but where the amount that the creditor received exceeded the amount of debt thus extinguished, such transaction is voidable to the extent it exceeds the extinguished amount, insofar as the requirements described above are met.

Any transaction that the debtor made after cessation of payments or within six months prior thereto is voidable, insofar as the debtor received no or substantially no consideration.

The debtor's act of assigning its assets for reasonable consideration is voidable, if:

- the assignment of the assets generates the actual risk of concealment, gift, or other transaction that impairs the other creditors, by changing the form of the assets (such as the conversion of real estate into cash);
- the debtor had the intention of conducting concealment, etc, of the consideration; and
- the beneficiary was aware of the debtor's above intention of concealment, etc.

Granting a Preference

The following transactions are, as long as they create security for, or extinguish, any existing claims, voidable.

The debtor collateralised its assets to secure an existing claim, or paid for an existing claim, after the debtor became generally unable to make payments, or the filing of a petition for any of the insolvency proceedings, with knowledge of either:

- the debtor's general inability to make payments or the cessation of payments, or when the transaction was made after such general inability to make payments; or
- the fact that a filing for any insolvency proceeding was made, when the transaction was entered into after the filing.

The debtor collateralised its assets to secure an existing claim, or paid against an existing claim, after, or within 30 days before, the debtor became generally unable to make payments, despite that the debtor was not obligated to do so at all, or was not obligated to do so at the time actually done, except where the creditor was unaware of the fact that such collateralisation or payment impaired other creditors.

12.2 Look-back Period

The right of avoidance may not be exercised if two years have elapsed since the date of commencement of civil rehabilitation proceedings, corporate reorganisation proceedings or

bankruptcy proceedings or 20 years have elapsed since the date of the voidable act.

12.3 Claims to Set Aside or Annul Transactions

Although there is no statutory basis for a creditor to request to set aside or annul a transaction, a creditor may, in practice, request a supervisor, reorganisation trustee or a bankruptcy trustee to avoid a particular transaction or, at least, investigate whether the transaction shall be subject to avoidance.

13. Trading Debt and Debt Securities

13.1 Limitations on Non-banks or Foreign Institutions

There is no limitation on non-banks or foreign institutions for holding loans or bonds in Japan. If a foreign institution is making a loan in Japan or an investment to a Japanese company, specific authorisation may be required under the Money Lending Business Act and/or the Foreign Exchange and Foreign Trade Act.

13.2 Debt Trading Practices

For the purpose of the loan trade, assignment of the loan claim is most typical. The assignment can be perfected either by (i) notice to a borrower or acknowledgment by a borrower, with a document bearing the fixed date, of the fact that the loan claim was assigned to a third party, or (ii) registration of the assignment. It is necessary for the assignor and assignee to notify the borrower and the relevant court in order that the assignee will be officially treated as the creditor in the relevant judicial insolvency proceedings.

13.3 Loan Market Guidelines

The Japan Syndication and Loan-trading Association ("JSLA") provides several standard agreements and guidelines including a standard loan trading agreement.

13.4 Transfer Prohibition

If there is a clause prohibiting transfer of the loan claim without consent of the borrower, then the transfer of the claim is not valid unless (i) the transferee is not aware of the prohibition clause without gross negligence, or (ii) the borrower give consent on the transfer.

14. The Importance of Valuations in the Restructuring and Insolvency Process

14.1 Jurisprudence Related to Valuations

Valuation plays a significant role in restructuring. For example, in the proceedings for revitalisation – such as corporate reorganisation and civil rehabilitation – it is necessary for the debtor to ensure that the creditor's recovery of the unsecured claims in these proceedings will be higher than those in bankruptcy proceedings. In the out-of-court workouts, it is sometimes necessary to ensure that the recovery is better than those in the judiciary insolvency proceedings. In addition, as to the collateral valuation, it is always an important matter between the debtor and the secured creditor.

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