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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN JAPAN

Welcome to Module 8G, dealing with the insolvency system of Japan. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Japanese insolvency laws;
- a relatively detailed overview of the Japanese insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of Japan.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2024**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2024 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Japan:

- the background and historical development of insolvency law in Japan;
- the various pieces of primary and secondary legislation governing Japanese insolvency law;
- the operation of the Civil Rehabilitation Act, Corporate Rehabilitation Act, Bankruptcy Act and Companies Act and other legislation in regard to bankruptcy, liquidation and corporate rescue;
- the rules of international insolvency law as they apply in Japan; and
- the rules relating to the recognition of foreign judgments in Japan.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Japanese insolvency law; and
- be able to answer questions based on a set of facts relating to Japanese insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through the text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO JAPAN

Japan, positioned in East Asia, is a nation characterised by its island geography, entirely surrounded by the sea without any land borders connecting it to continents. Due to its limited natural resources, the country relies on the importation of essentials like petroleum, food and minerals from other nations. Nevertheless, Japan is a major player in global trade, owing its impressive export performance to diverse industrial output, a transition towards high-value products, competitiveness, and its leading role in various industries. As of 2022, it stands as the world's third-largest economy in terms of gross domestic product (GDP), renowned for its well-established industrial and technological foundations, particularly in advanced manufacturing and export-focused sectors.

In terms of its political structure, Japan operates as a parliamentary constitutional monarchy, functioning under a democratic system of governance. While the Emperor of Japan holds a symbolic and ceremonial position, all governmental decisions are handled by the three branches: the executive, legislative and judicial. The executive branch is led by a prime minister who serves as the leader of the ruling political party. Japan operates within a multi-party system and upholds a tradition of political stability.

The Japanese Constitution, effective since 1947, emphasises key principles such as sovereignty, the protection of fundamental human rights, and the pursuit of peace. It also underscores the notion of the separation of powers, establishing three independent bodies: the Diet, the Cabinet and the Judiciary. These bodies operate with a system of checks and balances, effectively limiting the authority of one another to prevent the misuse of power and to ensure the preservation of the rights and freedoms of the people.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

4.1.1 General legal system

Japan has a legal system primarily rooted in civil law, characterised by a set of codified laws that include the Constitution as the supreme law, and five major codes covering various legal domains: civil, civil procedure, criminal, criminal procedure and commercial. The domestic legal landscape has expanded to encompass thousands of additional pieces of legislation and numerous regulations, including Cabinet and Ministerial ordinances. Case law plays a significant role in interpreting existing legislation and even shaping new legal principles in areas where legislation is inadequate.

In the fields of commercial law and taxation, case law holds particular importance and is closely monitored by legal professionals and academics. Furthermore, Japan's legal framework has been influenced by common law concepts, rules and regulatory patterns, especially as observed in the European Union. This hybridised approach is evident in areas like bankruptcy reform. In essence, Japan's legal system combines various legal influences while maintaining its civil law foundation, resulting in ongoing changes and developments within its legal framework.

4.1.2 Brief history of insolvency laws

The first insolvency legislation to fully embrace Western legislation was the provisions of the Bankruptcy Chapter of the Commercial Code of 1890 and the Law on the Dispersion of Household Assets. Here, as in the Commercial Code as a whole, French law was used as a model. However, since there was much criticism of these laws, and since the Civil Procedure Law was subsequently enacted on the model of German law, a revision was discussed soon after the legislation was enacted. As a result, these laws were repealed, and the current Bankruptcy Act was enacted, heavily influenced by German law, and came into effect in 1923. At the same time, as a system of bankruptcy prevention, the "Wagi" Law was enacted and enforced as Japan's first restructuring-type insolvency legislation, referring to its Austrian counterpart, which was the latest legislation at the time.

In 1938, the special liquidation and company liquidation systems were newly introduced. The former is a liquidation-type procedure and the latter is a restructuring-type procedure, both of which were simplified versions of the bankruptcy and "Wagi" laws.

In 1952, the Corporate Reorganisation Act (Act No 154 of 2002) was legislated, and the Bankruptcy Act was amended to introduce a discharge concept. Both of these were strongly influenced by the legislation of the United States (US), which was occupying Japan at the time.

In 2000, the Civil Rehabilitation Act (Act No 225 of 1999) was enacted, replacing the existing "Wagi" Law, for the basic restructuring-type insolvency proceedings, mainly for the purpose of rehabilitation of small and medium-sized enterprises.

In 2001, a new restructuring-type insolvency procedure for consumers was established. In the midst of a large number of consumer bankruptcies, the procedure was in demand, in which individual debtors with regular income can pay their creditors from their future income and avoid liquidation of their homes and other assets.

In the same year, international insolvency legislation was also developed. In the past, the Japanese legal system had been strongly criticised both domestically and internationally for its territoriality towards international insolvency cases, but this attitude has fundamentally changed. Specifically, the Act on Recognition and Assistance in Foreign Insolvency Proceedings was newly established to provide recognition and various types of assistance to foreign insolvency proceedings, and the Bankruptcy Act, the Corporate Reorganisation Act, and the Civil Rehabilitation Act were amended to provide for international insolvency-related provisions.

4.2 Institutional framework

Japan has a three-tiered court system where dissatisfied individuals can appeal court decisions to other tiers. The Supreme Court serves as the court of final instance, established under the Constitution. Additionally, the Court Act has established lower courts: the Courts of Appeal (High Courts), District Courts, Family Courts and Summary Courts. No extraordinary courts can be established, nor can any Executive bodies have final judicial power.

The Supreme Court comprises the Chief Justice and 14 Justices. They handle appeals, along with impeachment cases against commissioners. Trials are heard by a Grand Bench of 15 Justices and three petty benches of five Justices each. Cases involving constitutional questions are transferred to the Grand Bench for inquiry and adjudication.

Courts of Appeal (High Courts) are located in major cities across Japan and handle appeals against district and family court decisions. Furthermore, in April 2005, a specialised branch known as the Intellectual Property High Court was established under the Tokyo High Court. They also have original jurisdiction in administrative cases related to elections and certain criminal cases. Typically, cases in a (high) court of appeal are handled by a three-judge panel.

District Courts are found in 50 cities: one in every prefecture (four in Hokkaido). They usually serve as the courts of first instance and also have jurisdiction over appeals against summary court decisions and rulings in civil cases. Usually a single judge or a three-judge panel presides over the trial in a district court.

Family Courts are in the same locations as the district courts and their branches. They deal with domestic disputes, such as those between married couples and between parents and children, as well as cases involving juvenile delinquents.

There are 438 **Summary Courts** in Japan. They have first-instance jurisdiction over civil cases where the disputed sum does not exceed JPY 1,400,000 (approximately USD 10,000),[1] and over criminal matters punishable by fines or lighter punishment.

[1] Assuming USD 1 = JPY 138.

The court is always involved in judicial insolvency procedures: bankruptcy, civil rehabilitation and corporate reorganisation. The district courts handle every insolvency case, and branches of the district courts may also handle some of those cases. The jurisdiction determines which district court handles each case, which is typically the location of the debtor's principal business office, or the debtor's property if they have no such offices in Japan. Additional jurisdiction of larger courts is granted for large-scale cases. For cases involving 500 or more creditors, a petition can be filed with the district court where the court of appeal with original jurisdiction is located. For cases involving 1,000 or more creditors, a petition can be filed with the Tokyo District Court or Osaka District Court. Since complex processes may be required for large-scale cases, the jurisdiction of large courts with specialised divisions is allowed. Both the Tokyo District Court and Osaka District Court have separate specialised divisions that handle insolvency cases. There is no insolvency regulator in Japan.

Self-Assessment Exercise 1

Describe the special treatment of cases with a number of creditors.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

5.1 Introduction

In Japan, security can be broadly divided into real security and personal security as it is in many other countries.

Real security is a mechanism for preferentially collecting debts from property owned by the debtor or a third party. A typical one in Japan is a mortgage. A third party also can provide its specific property for collateral as a mortgagor or pledgor for another person's debt.

One feature of a real security interest is the right of priority payment. The property over which a security interest under statutes has been established can be sold through judicial procedures such as auction, and the secured claim can be collected from the proceeds preferentially before other creditors. Therefore, the creditor has the advantage of ensuring the collection of its claims as long as it only has to pay attention to the maintenance of the collateral, resulting in the saving of monitoring costs.

On the other hand, some collateral must be perfected by registration in the relevant property registry to demonstrate that a security interest has been created over that property. Without such registry, it is impossible to assert the security interest against other creditors. In addition, the execution of real security often requires a public auction procedure, and the creation and execution of such security interests is time-consuming and costly. Due to these characteristics, real security is mainly suitable for long-term security and substantial borrowings.

Personal security is a mechanism for recovering claims from the assets of a person other than the debtor who is also responsible for the debt. A guarantee[2] is a typical example in Japan. The main feature of personal security is its quickness and simplicity because it is created only by a contract between the creditor and the guarantor without a registry. On the other hand, the right to collect claims preferentially does not arise from personal security itself.

5.2 Real security

5.2.1 Forms of real security

Real security has two classifications. The first one is in terms of the security's formation, largely (i) statutory security interests, which are naturally established, irrespective of the intention of the parties if certain legal requirements are met such as statutory liens, and (ii) contractual security interests, created by agreement of the parties, such as mortgages and pledges.

In addition, security interests are further classified in terms of whether they are (a) stipulated in the Civil Code, under statutes or (b) recognised by court precedents. Security interests under statutes are legally established as a right that should function as a security stipulated in the Property Rights Part of the Civil Code.[3] On the other hand, security interests recognised by court precedents are a right developed historically through transactional practices in order to overcome the inadequacy of the existing security interests under statutes, such as their time-consuming and costly features. These means of security can be executed in a simple procedure, for example, by allowing the debtor to vest certain rights, such as ownership, directly in the creditor and collecting the secured claim through the value by disposal to a third party when the debtor defaults.

The major security interests are as follows:

- Security interests under statutes:
  - mortgages (*teito ken*) and revolving mortgages (*ne teito ken*);
  - pledges (*shichi ken*);
  - statutory liens (*sakidori tokken*); and
  - rights of retention (*ryuchi ken*)
- Security interests recognised by court precedents, which are all contractual security interests:
  - security interests by way of assignment (*joto tanpo*);

[2] Civil Code (Act No 89 of 1896), art 446.
[3] *Idem*, arts 175 to 398-22.

- retentions of title (*shoyuken ryuho*); and

- provisionally registered ownership transfers (*kari toki tanpo)*.[4]

5.2.2 Functions of each type of real security

A **mortgage** is the right to take mainly real estate as collateral from the owner of the property, such as the debtor or a third party, and to receive satisfaction of the claim preferentially from the value of the subject property if the secured claim is not repaid. Unlike pledges, mortgages leave the possession and use of the property to the mortgagor. A **revolving mortgage** sets a certain limit in advance to secure claims arising from continuous transactions, and secures claims that will be determined in the future within that limit.

A **pledge** is the right to enforce a secured claim by retaining an object or a property right received by the creditor from the debtor or a third party as security for the claim, and in the absence of repayment, to receive priority repayment from the value (sales proceeds) of the object or the property right.[5] There are three types of pledges: pledges on movables, pledges on real estate, and pledges on property rights such as receivables.

A **statutory lien** is the right of repayment preferentially from the debtor's property with respect to certain types of claims.[6] There are a total of 15 types of statutory liens, including general statutory liens covering the debtor's entire liability property[7] and those covering specific movable or immovable property of the debtor.[8] For example, a statutory lien on immovable property is granted to a creditor with a claim arising from the preservation of the immovable property, construction work on that property, or its sale.

Regarding the **right of retention**, which is available for movables and immovables, when a person in possession of another person's property has a claim arising from that property, the person has the right to virtually enforce the payment of the claim by refusing to return the property until that payment is made.[9]

A **security interest by way of assignment** is a mechanism whereby the debtor or the guarantor transfers its rights to the creditor to secure the claim and agrees to return those rights once the claim has been paid. For example, when X provides a loan to Y and transfers the ownership of machine A owned by Y to X, this constitutes a security interest in the machine. If there is no repayment of the secured claim, the ownership of A will vest definitively in X. In addition to machines, receivables are also common to use for security interests by way of assignment.

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4 Provisionally registered ownership transfers are recognised as a legal right under the Act on Contract for Establishment of Security Interests by Use of Provisional Registration (Act No 78 of 1978).
5 Civil Code, arts 342 and 347.
6 *Idem*, art 303.
7 *Idem*, arts 306 to 310.
8 *Idem*, arts 311 to 328.
9 *Idem*, art 295, para 1.

A **retention of title** is a security method that facilitates the repayment obligation of the buyer in a sales contract, where the seller delivers the goods to the buyer and permits the buyer to use them but maintains ownership until the buyer has paid the sales price in full. If the buyer fails to do so, the seller may demand the return of the goods based on the right of ownership.

A **provisionally registered ownership transfer** is a mechanism to preserve, by provisional registration, the right to claim transfer of rights based on a contract that transfers the real estate ownership belonging to the debtor or the guarantor to the creditor in the event of default of the payment obligation.[10] A typical example is when X provides a loan to Y and enters into a contract that states "if Y does not repay the loan obligation, X shall exercise its right of reserved perfection and receive transfer of the land owned by Y as payment in lieu of the obligation", and preserves this right of reserved perfection by provisionally registering it.

5.2.3 Publicity for movable and immovable property

Japan has no central collateral registry, but perfection is done in different ways, depending on the type of property and security interest. The following is related to perfection of major properties, while different rules apply to intellectual property and financial instruments like stocks:

For immovable property, Japan has a registration system for publicising the legal rights like ownerships and mortgages in real estate. Mortgages and revolving mortgages over real estate are perfected by registration in the relevant property registry.[11]

For tangible movable property, the right of movables is generally perfected by delivery of the property, including actual delivery, summary delivery and transfer of possession by instruction, but excluding constructive delivery.[12] Pledges over movable property are perfected by continuous possession of the collateral.

For intangible property, the assignment of claims such as receivables is perfected against the debtor by the assignor (the creditor) giving notice to, or obtaining acknowledgement from, each debtor. Using an instrument with a fixed and certified date for these notices or acknowledgments also achieves perfection against third parties.[13]

Separately, there is a registration system for security interests by way of assignment for movables and claims, where the assignor, which is a grantor of the security assignment, is a corporation.[14] Security assignments for movables and claims can be perfected against third parties by either of the aforementioned methods or registration methods.

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10 Act on Contract for Establishment of Security Interests by Use of Provisional Registration, art 1.
11 Civil Code, art 177.
12 *Idem*, art 178.
13 *Idem*, art 467.
14 Act on Special Provisions, etc of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims (Act No 104 of 1998), art 3.

5.2.4 Secured assets upon insolvency

Regarding secured claims, under bankruptcy and civil rehabilitation proceedings, secured creditors may exercise the security interests outside the proceedings. While secured claims are not subject to investigation of claims, a secured creditor whose claim is not or unlikely to be completely covered by the security interests should provide evidence of the unsecured amounts to be eligible for the payment of those parts.

On the other hand, security interests under corporate reorganisations are prohibited from being executed upon commencement of the proceedings, or by the comprehensive prohibition order, which may be issued by the court beforehand. A secured claim may only be paid in line with the reorganisation plan. The trustee evaluates the collateral based on its present value as of the commencement date, which may be challenged by the secured creditor. Any portion of a claim exceeding the value of the collateral is deemed as an unsecured claim.

5.2.5 Potential future developments

As further explained in paragraph 9.2, the reform of secured transaction law is under consideration by the Japanese government. The aim is to more clearly regulate security interests recognised by court precedents, including security assignments and sales with retention of title. As explained above, these transactions are commonly used to secure financing but have relied on court precedents, resulting in ambiguity. The upcoming reforms are expected to introduce rules providing clarity on security assignment rules, order of priority amongst competing security interests, their enforcement, and their treatment in insolvency proceedings. Additionally, a new concept of an all-assets security interest called "Business Growth Security Interest" is also being considered.

5.3 Personal security

Personal security is what a third party, such as a guarantor, is liable for regarding another person's obligation. The guarantee contract is agreed only between the creditor and the person who wants to become a guarantor. Therefore, even if there is another creditor against the debtor, the guarantor is not claimed from that creditor unless the guarantee contract is also agreed with the guarantor.

Personal security is commonly broken down into three types, as further explained below: guarantee; joint and several guarantee; and revolving guarantee.

5.3.1 Guarantee

A guarantee contract is the most basic form of personal security. The guarantor is liable for the obligation when the debtor fails to perform it. However, the guarantor may first demand that the creditor claim against the debtor (defence of demand). In addition, the guarantor can request that repayment should be made from the debtor's property when the debtor is proved to have the ability to repay the debt and the contract is easy to execute (defence of search).

The guarantee obligation is created by the guarantee contract between the creditor and the guarantor. The contract must be made in writing to be legally effective. As of April 2020, the written contract must be notarised within one month before its execution if the individual becomes a guarantor for the business loan.[15]

When the primary obligation is reduced by the debtor by partial payment, the guarantor's responsibility is also reduced, and when the payment term of the primary obligation is extended, that of the guarantee obligation is also extended.

A wide range of the debt can be guaranteed, including the future debt which has not yet occurred at the time of the guarantee contract. Further, details of the primary obligation must be explained to the guarantor upon execution of the contract.

5.3.2 Joint and several guarantee

A joint and several guarantee contract is a guarantee contract in which defences of demand and search are not allowed. The creditor can demand the guaranteed obligation of the joint and several guarantors without demanding it of the debtor. Therefore, they are in a nearly equal position with the debtor.

Since the joint guarantee contract is a kind of guarantee contract, the same requirements apply as they do with guarantee contracts. The intention "to jointly guarantee" must be clearly stated in the contract.

5.3.3 Revolving guarantee

A revolving guarantee comprehensively guarantees multiple claims arising from a continuous contract between the creditor and the debtor. Normally, a guarantee contract has one specific primary obligation. However, in the case of continuous transactions, it is more effective to collectively guarantee multiple debts that arise during the guarantee period, rather than entering a contract each time. Generally, the contract states a certain limit of the guaranteed amount.

Since the amount of the primary debt fluctuates, it may become a large burden especially for an individual guarantor. Therefore, when the guarantor is an individual and the primary debt is a loan, a maximum amount must be set and the term must be limited to five years in order to protect the guarantor.

Self-Assessment Exercise 2

Under Japanese law, what options are there for security interests over tangible movables? Outline the possible measures.

[15] Civil Code, art 465-6.

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

6.1.1 Classifications of proceedings

6.1.1.1 In-court proceedings

There are two directions to classify in-court insolvency proceedings: the purpose and the manner of the proceedings.

Procedures can be categorised into two primary purposes: (i) liquidation-type procedures, involving the disposal and equal distribution of the debtor's assets among creditors, and (ii) restructuring-type procedures, aiming to reorganise the debtor's business or financial affairs, where the earnings and income generated from the restructured business serve as a means to repay creditors.

The manner of the proceedings themselves includes a: (i) management-type procedure in which the debtor forfeits the right to manage and dispose of the debtor's property and business upon commencement of the procedure and appoints a third party such as a trustee to manage the property and business; and (ii) debtor-in-possession-type (DIP-type) procedure in which the debtor itself retains the right to manage and dispose of the property and business after the procedure is commenced.

Currently, the three main in-court insolvency proceedings are bankruptcy proceedings (*hasan*, liquidation and management-type), civil rehabilitation proceedings (*minji saisei*, restructuring and DIP-type) and corporate reorganisation proceedings (*kaisha kosei*, restructuring and management-type). Other special procedures include special liquidation procedures (*tokubetsu seisan*), and recognition and assistance procedures to provide necessary assistance dispositions in Japan for foreign insolvency proceedings. In principle, each proceeding is based on a different law, which means the Japanese insolvency laws are contained in multiple pieces of legislation as follows:

- bankruptcy proceedings: Bankruptcy Act (Act No 75 of 2004);
- special liquidation: Companies Act (Act No 86 of 2005);
- civil rehabilitation proceedings: Civil Rehabilitation Act;
- corporate reorganisation proceedings: Corporate Reorganisation Act; and

- recognition of foreign insolvency proceedings – Act on Recognition of and Assistance for Foreign Insolvency Proceedings.

6.1.1.2 Out -of-court proceedings

In addition to these in-court insolvency proceedings, Japan has several rule-based out-of-court workout proceedings:

- Turnaround ADR (alternative dispute resolution);
- Small and Medium-Sized Enterprise Revitalization Councils;
- rehabilitation-type out-of-court workouts for small and medium-sized enterprises;
- Regional Economy Vitalization Corporation of Japan (REVIC); and
- special conciliation,

which are basically carried out by agreement between the parties, and these play an important role in actual insolvency practices. These are further explained in detail in paragraph 6.5.2.4.

6.1.2 Debtor-friendly insolvency system

The Japanese insolvency process has generally been acknowledged as being debtor-friendly. In restructuring procedures, the creditor is not allowed to take the lead or exert influence over the process in Japan, either legally or factually. For example, in most cases, the debtor in civil rehabilitation proceedings (*minji saisei* as further explained in paragraph 6.5.2) or the trustee in corporate reorganisation proceedings (*kaisha kosei* as further explained in paragraph 6.5.3) has the authority to oversee nearly the entire restructuring process.

In addition, nearly the entire liquidation process is controlled by the trustee in bankruptcy proceedings (*hasan*) or the liquidator in special liquidation proceedings (*tokubetsu seisan*). Furthermore, forming a creditors' committee is not mandated by statutes. In reality, such committees are rarely established or acknowledged by the court. One of the causes of this outcome is that creditors can create their own creditor groups, which is sometimes enough for their recovery needs.

6.2 Personal / consumer insolvency

6.2.1 Overview of consumer insolvency proceedings in Japan

In Japan, there are several options for consumers to select from to address their insolvency, relying on the extent of their ability to repay.

Common consumer insolvency proceedings involve out-of-court negotiation (*nin-i seiri*), special conciliation (*tokutei chotei*)[16] or individual rehabilitation (*saisei*),[17] as well as consumer bankruptcy (*hasan*).[18]

Out-of-court negotiation is a method whereby the debtor does not involve the court or other public institution but negotiates directly with the creditors to reach an agreement or settlement on a debt payment method.

Special conciliation involves a court mediator who works with the creditors to reach an agreement on how the debt is to be repaid.

Individual rehabilitation proceedings are simplified versions of civil rehabilitation proceedings for consumers, including rehabilitation for individuals with small-scale debts (*shokibo kojin saisei*) and debt rehabilitation for salaried workers (*kyuyo shotokushato saisei*). Individuals can utilise these in addition to the normal civil rehabilitation proceedings.

Consumer bankruptcy is distinct in that most consumer debtors are discharged and do not disappear like corporations do after the proceedings. The discharge procedure is a means of economic rehabilitation for debtors, as the purpose of the Bankruptcy Code explicitly states: "to ensure that debtors have the opportunity to rehabilitate their economic lives". Additionally, consumers have fewer assets to contribute to an estate in most cases.

In general, the debtor selects out-of-court negotiation or special conciliation if they can repay the entire principal with three to five years of income, individual rehabilitation if it is difficult to repay the entire principal but a substantial amount can be repaid, or, if even that is difficult, bankruptcy to be discharged.

6.2.2 Consumer bankruptcy

Bankruptcy proceedings for consumers are managed in almost the same manner as those for corporations, especially on the substantive legal matters. The following are particular issues for consumers or proceedings compared to those for corporate bankruptcy.

6.2.2.1 Commencement of bankruptcy proceedings

Bankruptcy proceedings are applicable to all natural persons, not limited to Japanese citizens. Creditors and debtors are entitled to petition for the commencement of bankruptcy proceedings.

Upon commencement of bankruptcy proceedings, insolvent individuals are restricted in various ways. Major restrictions are applied to one's residence, private telecommunications and job qualification. Firstly, the insolvent cannot leave their place of residence without the court's

[16] Based on the Act on Special Conciliation for Expediting Arrangement of Specified Debts (Act No 158 of 1999).
[17] Based on the Civil Rehabilitation Act.
[18] Based on the Bankruptcy Act.

permission[19] to ensure that they fulfil their obligation of explanation. Secondly, the court may, if necessary, permit the postal carrier to forward any post addressed to the insolvent to the trustee,[20] in which case the trustee may open and read such forwarded post.[21] Thirdly, the insolvent is not qualified to certain occupations such as attorney-at-law, accountant, security guard or testamentary executor.[22]

As previously mentioned, consumers have fewer assets to contribute to an estate in most cases. If the insolvent does not have sufficient assets to cover the procedural expenses of JPY 200,000 (approximately USD 1,430),[23] the bankruptcy procedure is discontinued as is the appointment of a trustee, which is called the simultaneous discontinuance of bankruptcy proceedings.[24] There will be no further bankruptcy proceedings, and a separate hearing will be held on the discharge procedure. Simultaneous discontinuance is common in consumer bankruptcies.

6.2.2.2 Exempt property

Certain property is not allowed to belong to the bankruptcy estate and may especially not be kept by insolvent consumers, which property is called exempt property. Exempt property includes (i) newly acquired property after the commencement of bankruptcy proceedings, which enables the insolvent to ensure sufficient resources to rebuild their life economically, (ii) property prohibited from being seized such as public insurance benefit claims and welfare benefits under the applicable laws, and (iii) property abandoned from the estate by the trustee.

6.2.2.3 Discharge

One of the main reasons for consumers to file for bankruptcy is generally to obtain a discharge of debts. The discharge procedure is structured separately from the bankruptcy procedure. However, under the Bankruptcy Act, when bankruptcy proceedings are filed, the debtor is deemed to have simultaneously filed for discharge, unless the debtor indicates a contrary intention.[25]

The discharge is always granted as long as there are no grounds for non-exemption.[26] Grounds for non-exemption include (i) concealment, destruction or adverse disposition of property, (ii) non-obligatory fraudulent acts, (iii) gambling, (iv) borrowing through fraudulent means that deceive creditors, (v) obstructing the duties of a trustee by dishonest means, or (vi) violating any obligations during bankruptcy proceedings.[27] In some cases, the court finds grounds for non-exemption, such as extravagance or gambling, where granting a discharge will be difficult.

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19 Bankruptcy Act, art 37.
20 *Idem*, art 81.
21 *Idem*, art 82.
22 Each law governing the qualifications stipulates the respective restrictions.
23 Assuming USD 1 = JPY 140.
24 Bankruptcy Act, art 216.
25 *Idem*, art 248, para 4.
26 *Idem*, art 252, para 1.
27 *Idem*, art 252.

On the other hand, even if there are grounds for non-exemption but they are minor, the discharge may be granted at the court's discretion.[28]

Upon the discharge order, the insolvent is discharged from liability for all debts owed to the bankruptcy creditors.[29] However, some claims are considered as non-exempt claims and are not discharged.[30] Non-dischargeable claims include (i) taxes and fines, (ii) claims for damages based on tortious acts committed by the insolvent in bad faith, (iii) claims for damages based on torts committed by the insolvent that harm the life or body of a person through wilful misconduct or gross negligence, and (iv) the right to claim alimony and marital expenses. In addition, the effect of the decision to grant discharge shall not extend to the guarantor or the third-party mortgagor / pledgor.[31] When the discharge order has become final and binding, reinstatement is usually granted.[32]

6.2.3 Individual rehabilitation

In Japan, the Civil Rehabilitation Act offers two types of restructuring processes for consumers: (i) rehabilitation for individuals with small-scale debts (small-scale debt rehabilitation for individuals), and (ii) debt rehabilitation for salaried workers. Both are simplified restructuring-type procedures, which are specifically designed for individual debtors seeking to avoid bankruptcy and rebuild their financial lives.

In individual rehabilitation, there are also special provisions regarding the rules of insolvency substantive law. The most significant of these is the absence of avoidance, whereas restrictions on set-off and rules concerning executory contracts are the same as in ordinary civil rehabilitation. The rules and procedures particular to these simplified proceedings are explained as follows.

6.2.3.1 Small-scale debt rehabilitation for individuals

Commencement of the proceedings

The main feature and requirement of small-scale debt rehabilitation for individuals is that the debtor is expected to earn income continuously or repeatedly in the future.[33] It is sufficient to have continuous income or the prospect of recurring income, even if it is not regular or fluctuates. Such debtors may pay debts from their future income without liquidating their current assets, enabling them to pay more to creditors than in the case of bankruptcy and to achieve economic rehabilitation. Therefore, it is used as a simplified rehabilitation procedure instead of bankruptcy.

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28 *Idem*, art 252, para 2.
29 *Idem*, main clause of art 253, para 1.
30 *Idem*, proviso of art 253, para 1.
31 *Idem*, art 253, para 2.
32 *Idem*, art 255, para 1.
33 Civil Rehabilitation Act, art 221, para 1.

A petition may be filed only when the total amount of rehabilitation claims is JPY 50 million (approximately USD 357,000)[34] or less. When the amount of claims affected by the proceedings is relatively small, the proceedings should be simplified from the standpoint of cost-effectiveness. The total amount of claims does not include (i) home loan claims, (ii) rehabilitation claims that are expected to be paid by exercising the right of separate satisfaction, or (iii) any fines incurred prior to the commencement. This is because these claims are not subject to reduction or exemption based on a rehabilitation plan.

Appointment of individual rehabilitation commissioners

Unlike ordinary rehabilitation, there are no trustees, supervisors or investigators, but instead an individual rehabilitation commissioner is established, or, if necessary, the court may appoint one at its discretion to, like an investigator, investigate the debtor's assets, evaluate rehabilitation claims, and assist with drafting a rehabilitation plan.[35]

The duties of individual rehabilitation commissioners include (i) investigation of the rehabilitation debtor's assets and income status, (ii) assisting the court with the valuation of rehabilitation claims, and (iii) advising the debtor on the preparation of an appropriate rehabilitation plan.[36] However, not all of these are automatically included in the commissioner's duties, as the court designates one or more when appointing the individual rehabilitation commissioner.

Investigation of claims

The debtor shall submit a list of creditors when filing for the proceedings.[37] This list shall include the names of rehabilitation creditors and the amount and cause of the rehabilitation claims, and be notified to known rehabilitation creditors.[38] Creditors who do not object to the contents of the list are not required to file proofs of their own claims.[39] This is to simplify the procedures for such filings and conducting investigations, simplifying the entire procedure compared to ordinary rehabilitation. Creditors who are not included in the list of creditors or who object to the list of creditors, even if they are included, are required to file proofs of their claims within the designated filing period.

Details of the plan

In small-scale debt rehabilitation proceedings for individuals, the rights of the creditors must be modified equally in the rehabilitation plan, except in the case of creditor consent, small claims or substantially subordinated claims.[40]

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34 Assuming USD 1 = JPY 140.
35 Civil Rehabilitation Act, main clause of art 223, para 1.
36 *Idem*, art 223, para 2.
37 *Idem*, art 221, para 3.
38 *Idem*, art 222, para 4.
39 *Idem*, art 225.
40 *Idem*, art 229, para 1.

The repayment terms must be (i) instalment payments due at least once every three months, and (ii) a repayment period of three years in principle, which may be extended to five years under special circumstances.[41]

There are some types of claims that cannot be modified by a rehabilitation plan without the consent of the creditors.[42] Specifically, they are (i) the right to claim damages based on a malicious tort, (ii) the right to claim damages based on an intentional or grossly negligent tort that causes harm to a person's life or body, and (iii) the right to claim marriage expenses, alimony and child custody expenses. It is not appropriate from the viewpoint of creditor protection to discharge these rights by partial payment even in restructuring-type proceedings. Therefore, these claims are subject to scheduled payment during the term of the payment plan, and the remaining amounts are to be paid in a lump sum at the end of the term.[43]

Voting on the plan and completion of the proceedings

A proposed rehabilitation plan is submitted after the claims are investigated and the debtor's report is submitted.[44] The resolution is adopted by a written vote,[45] or by opt-out in which any person who disagrees with the proposed rehabilitation plan makes an objection.[46] The procedure is intended to be simplified since the minimum repayment amount is guaranteed. The requirements for approval are that the number of creditors who do not consent is less than half of the total number of voting right holders and that the number of their voting rights does not exceed half of the total number of voting rights held by all voting holders.[47]

If the proposed rehabilitation plan is approved, the court will make a decision to confirm. The grounds for disconfirmation include the grounds for disconfirmation of rehabilitation proceedings in general,[48] cases where the requirements for commencement of proceedings are not met,[49] and cases where the minimum payment requirement is not met.[50]

If there are no grounds for disconfirmation, the court shall make a confirmation order of the rehabilitation plan.[51] Upon the confirmation order, the rights of all rehabilitation creditors shall be modified.[52]

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41 *Idem*, art 2, para 2.
42 *Idem*, art 229, para 3.
43 *Idem*, art 232, para 4.
44 *Idem*, art 230, para 1.
45 *Idem*, art 230, para 3.
46 *Idem*, art 230, para 4.
47 *Idem*, art 230, paras 4 and 6.
48 *Idem*, art 174, para 2.
49 *Idem*, art 231, para 2, items 1 and 2.
50 *Idem*, art 231, para 2, items 3 and 4. The rules for the minimum payment amount are complex, but the standard claim that serves as the basis for that amount is a claim that excludes secured claims with the right of separate satisfaction and subordinated claims from the claims that have been determined in the proceedings.
51 *Idem*, art 231, para 1.
52 *Idem*, arts 156 and 232, para 2.

The proceedings are completed as a matter of course when the confirmation order of the rehabilitation plan becomes final and binding.[53] Even if an individual rehabilitation commissioner is appointed, they do not need to supervise the performance of the plan due to its simplicity and affordability of the procedure.

6.2.3.2 Debt rehabilitation for salaried workers

The debt rehabilitation procedure for salaried workers is a procedure for debtors whose income is regular and stable, making it easy to calculate and make planned payments to creditors,[54] while small-scale debt rehabilitation for individuals is for cases where it is difficult to calculate disposable income. This procedure does not require rehabilitation creditors' consent to the proposed rehabilitation plan at all, which is simpler and quicker for debtors with regular and stable income.

The only differences from small-scale debt rehabilitation for individuals are (i) the regular income requirement, (ii) that a resolution by the creditors is unnecessary, and (iii) the disposable income requirement for confirmation of the rehabilitation plan.

6.2.4 Special conciliation

Since special conciliation involves a court mediator who works with the creditors to reach an agreement on how to pay the debt, it is more advantageous in terms of procedural simplicity and low cost compared to individual rehabilitation. As mentioned in paragraph 6.2.3, individual rehabilitation is also simplified, but a certain degree of complexity, time and effort is required as it is for in-court proceedings, for example, for the investigation of assets and claims and the rehabilitation plan resolution. Meanwhile, special conciliation is an extremely simple procedure. Since only a conciliation commissioner, whose expenses and remuneration are fully borne by the State, is involved, and usually no representative is required, the cost is extremely low.

On the other hand, special conciliation is only based on an agreement between the parties, despite it being a court procedure. Therefore, it does not have the same effect as bankruptcy or individual rehabilitation, and the debt is not reduced significantly without the creditor's consent. The amount of debt may remain the same, and only instalments are negotiated in many cases.

Self-Assessment Exercise 3

Question 1

What distinct aspects do personal insolvency proceedings have compared to corporate insolvency proceedings?

[53] *Idem*, art 233.
[54] *Idem*, art 239.

Question 2

How can one select a proceeding for consumer insolvency among possible measures?

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Corporate liquidation

6.3.1 Bankruptcy

6.3.1.1 Filing for bankruptcy proceedings

In a corporate bankruptcy, not only the debtor and creditor themselves, but also their directors, executive officers and liquidators have the right to file for bankruptcy proceedings.[55] In addition, the supervisory authorities may file for bankruptcy of financial institutions such as banks and insurance companies from the viewpoint of protecting their customers.[56]

Although Japanese insolvency law was modelled after the comparable German law, Japan basically does not follow the obligation to initiate bankruptcy proceedings as adopted by Germany.[57] One exception is that the liquidator of a liquidating company is required to file for bankruptcy proceedings when it has become clear that the company does not have sufficient assets to fully discharge its debts.[58] This is because the liquidator is responsible for leading the liquidation under an impartial and open insolvency process.

6.3.1.2 Freezing the assets and ordering stays before the commencement of proceedings

Once a petition has been filed, the court may take preservative measures prior to the order of commencement of bankruptcy proceedings if it is necessary to maintain and secure the debtor's property or to restrict the exercise of creditors' rights. Typical temporary restraining orders include prohibiting payment and the disposition or transfer of possession of property.[59]

6.3.1.3 Commencement of bankruptcy proceedings

When the court finds any facts constituting the stipulated grounds, it orders the commencement of bankruptcy proceedings. The most basic grounds for initiating bankruptcy proceedings are

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55 Bankruptcy Act, art 19.

56 Act on Special Measures for the Reorganisation Proceedings of Financial Institutions (Act No 95 of 1996), art 490.

57 In the past, Japanese law obligated directors to file but this was abolished because such coercion did not work effectively, so, rather, policies have been adopted that provide for restructuring-type bankruptcy procedures to guide them to legal proceedings.

58 Companies Act, art 484, para 1 and Act on General Incorporated Associations and General Incorporated Foundations (Act No 48 of 2006), art 215.

59 Bankruptcy Act, art 28.

the insolvency of the debtor. "Insolvency" refers to the debtor's lack of solvency and thus its general and continuous inability to pay its debts as they become due.[60] Therefore, insolvency is not found when a debtor is unable to pay merely a portion of its debts or is unable to make payments due to a temporary cash flow impasse.

In determining whether a debtor is insolvent, the court takes into consideration not only the debtor's assets, liabilities, income, earnings and expenses, but also its credit. In other words, if the debtor has sufficient credit and its obtainment of a new loan or deferment of repayment is considered possible, then insolvency will still not be recognised even though its current assets, income and earnings do not appear to be sufficient to repay its debts. When the debtor is a corporation, liabilities exceeding assets is also considered as cause for commencement of bankruptcy proceedings since excess debt indicates the inability to pay those debts in full with one's assets.[61]

On the other hand, the court dismisses the petition if it finds any grounds for dismissal of commencement of bankruptcy proceedings. The grounds include (i) failure to prepay the expenses for the proceedings, (ii) the petition being filed for an improper purpose or not being filed in good faith, or (iii) other bankruptcy proceedings have already been commenced.[62]

6.3.1.4 Moratoriums and stays upon the commencement of proceedings

The commencement of bankruptcy proceedings has the effect of giving the bankruptcy trustee the exclusive authority to manage and dispose of the assets belonging to the bankruptcy estate. This demonstrates that the bankruptcy creditors cannot exercise their individual rights during bankruptcy outside the proceedings.

As a result, the commencement of proceedings suspends the pre-existing lawsuits relating to the bankruptcy estate to which the insolvent is a party.[63] This is because the insolvent loses the right to manage and dispose of the bankruptcy estate and can no longer be a party to the proceedings. The bankruptcy trustee takes over the suspended actions that do not relate to bankruptcy claims. On the other hand, as for the proceedings regarding bankruptcy claims, the bankruptcy procedure would determine the existence of the claims after the creditor notifies the court of bankruptcy claims as further explained in paragraph 6.3.1.6.

6.3.1.5 Bankruptcy trustee

In bankruptcy proceedings, the bankruptcy trustee plays a central role in substantially leading the proceedings. As previously mentioned, the bankruptcy trustee has the exclusive right to manage and dispose of property belonging to the bankruptcy estate and has various procedural powers and duties. It stands in a position to take over the legal status of the insolvent and, at the same time, represents the interests of the bankruptcy creditors.

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60 *Idem*, art 2, para 11.
61 *Idem*, art 16.
62 *Idem*, art 30.
63 *Idem*, art 44, para 1.

The bankruptcy trustee is appointed by the court upon the commencement of bankruptcy proceedings.[64] Basically, one trustee is assigned per case, but more than one may be appointed. For large cases, even if there is only one trustee, a number of bankruptcy trustee representatives are appointed to co-operate with and support the trustee. Bankruptcy trustees are lawyers in most cases.

6.3.1.6 Investigation of claims

In bankruptcy proceedings, the court and the trustee investigate the bankruptcy claims as follows.

Bankruptcy creditors are required to notify the court of the amount and cause of their claims within a certain period of notification, which is typically two weeks to four months.[65] Creditors notify by submitting a written form with the required information. This form of proof must state the amount and cause of the bankruptcy claim, the name and address of the creditor, and whether the claim has priority, is subordinate or is enforceable. The form must be attached with copies of evidential documents.[66]

Upon receipt of the proof of claim, an investigation of the bankruptcy claim itself is conducted. The trustee prepares a statement clarifying whether to approve or disapprove the filed claim and submits it to the court by the appointed deadline.[67] Other bankruptcy creditors may also object to the filed claim in writing, which may be based on the trustee's statement, within the period of investigation.

If the trustee approves the submitted claim upon investigation and no other bankruptcy creditors object, the bankruptcy claim becomes final.[68] If objections are raised, a judicial proceeding would commence and determine the existence of the claim and the amount.

6.3.1.7 Classification of claims

Bankruptcy claims

Bankruptcy claims are claims on property against the insolvent that arose from causes prior to the commencement of bankruptcy proceedings.[69] Secured creditors are also bankruptcy creditors with respect to their secured claims. Bankruptcy proceedings classify bankruptcy claims as "preferred", "subordinate" or "other" (general bankruptcy claims). The rights of bankruptcy claims must be exercised during the bankruptcy proceedings.[70] Therefore,

64 *Idem*, art 31, para 1 and art 74, para 1.
65 *Idem*, art 111.
66 Bankruptcy Rules, rule 32, art 111, para 1.
67 Bankruptcy Act, arts 117 and 119.
68 *Idem*, art 124.
69 *Idem*, art 2, para 5.
70 *Idem*, art 100.

bankruptcy creditors are not allowed to enforce execution or a temporary restraining order or file a suit outside of the proceedings.[71]

First, claims with statutory liens are entitled to distribution as preferred bankruptcy claims and have priority over other bankruptcy claims.[72] For example, priority of distribution is guaranteed for wage claims for which statutory liens are recognised in Japan. The order of priority amongst preferred bankruptcy claims is governed by substantive law.[73]

On the other hand, any creditors that hold security interests such as mortgages or pledges in specific property have "a right of separate satisfaction" with respect to those security interests, and are free to exercise them outside of bankruptcy proceedings.[74] In return, however, the amount of claims subject to voting and distribution in bankruptcy proceedings is limited to the portion of claims that are not expected to be repaid by exercising the right of separate satisfaction. The secured creditors should first collect the secured claims from the collateral and only when there is a deficiency will they be allowed to collect from the bankruptcy estate.

Claims on the estate

The Bankruptcy Act establishes another category of claims called claims on the estate (*zaidan saiken*)[75] and guarantees priority repayment for these claims over bankruptcy claims.

A typical claim on the estate is a claim for expenses necessary for the bankruptcy proceedings that arise after the proceedings commence, such as for expenses related to the management, realisation and distribution of the bankruptcy estate.[76] They are expenses incurred for the common interests of bankruptcy creditors. In that sense, it is natural that bankruptcy creditors as a whole should bear these expenses by granting priority to the creditors of these expenses over all bankruptcy creditors.

Tax and wage claims are also considered as claims on the estate. The protection of wage claims is limited to the three months prior to the commencement of bankruptcy proceedings.[77]

Claims on the estate may be paid when performance is due outside bankruptcy proceedings.[78] However, if the estate does not have sufficient assets and the full amount of the claims on the estate cannot be repaid, the claims on the estate are basically repaid proportionately to that entire amount.[79]

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71 *Idem*, art 42.
72 *Idem*, art 98, para 1.
73 *Idem*, art 98, para 2.
74 *Idem*, art 65, para 65.
75 *Idem*, art 2, para 7.
76 *Idem*, art 148, para 1, item 2.
77 *Idem*, art 149.
78 *Idem*, art 2, para 7.
79 *Idem*, art 152, para 1.

6.3.1.8 Collateral – separate satisfaction

As mentioned in paragraph 6.3.1.7 (sub-heading *Bankruptcy claims*), in bankruptcy proceedings, security interests such as mortgages are treated as rights of separate satisfaction.[80] All of the debtor's assets are ultimately liquidated and the proceeds are distributed in accordance with the order of the substantive law. Therefore, there is basically no need to restrict the exercise of security interests, which can be freely exercised outside of the bankruptcy proceedings. If there are any claims remaining after the execution of the secured interests, the remaining claims may be exercised as bankruptcy claims.[81]

6.3.1.9 Executory contracts

In general, legal relationships after the commencement of bankruptcy proceedings are maintained in their prior, original state. In particular, if the claims of both the insolvent and the counterparty to the contract remain outstanding upon commencement of the proceedings – that is to say, if both parties to the bilateral contract have not performed their obligations – the trustee is granted the right to choose whether to assume or reject the contract.[82] Contracts that are favourable to the bankruptcy estate are to remain in force, while unfavourable ones are to be cancelled. The claim of the counterparty to the contract that the trustee has elected to perform is protected as a claim on the estate,[83] while the claim for damages of the counterparty who has terminated the contract is considered as a bankruptcy claim.[84]

There are specific types of contracts that require special treatment in bankruptcy proceedings, one of which is lease contracts. As for the case of bankruptcy of the lessor, if the trustee in bankruptcy is free to terminate the contract, that results in an unreasonable situation where the lessee loses its own base for their life or business due to the economic collapse of the lessor who has no relationship with the lessee. Therefore, the Bankruptcy Act does not recognise the trustee's right to terminate the contract in cases where the lessee is able to assert its right of lease against a third party under the relevant legal requirements.[85] For example, in the case of a tenancy agreement, if the building is delivered before the commencement of bankruptcy proceedings, it cannot be terminated.

Regarding contracts with continuous performance, including electricity, water and gas provision contracts, if the recipient of the provision is in a bankruptcy proceeding, the provider may not refuse to perform its obligations once the proceeding has commenced on the grounds that it has not received payment for its bankruptcy claim prior to the filing for bankruptcy proceedings.[86] In this case, regardless of whether assumption or rejection is elected, the claim

[80] *Idem*, art 65, para 1.
[81] *Idem*, main clause of art 108, para 1.
[82] *Idem*, art 53, para 1.
[83] *Idem*, art 148, para 1, item 7.
[84] *Idem*, art 54, para 1.
[85] *Idem*, art 56, para 1.
[86] *Idem*, art 55, para 1.

on the performance rendered between the filing for bankruptcy proceedings and their commencement becomes a claim on the estate.[87]

6.3.1.10 Set-off and netting

The Bankruptcy Act allows bankruptcy creditors to offset their claims freely without bankruptcy proceedings even when proceedings have already commenced, if the bankruptcy claim and the debt owed to the insolvent are mutual, due and owed prior to such commencement.[88] The law clarifies that the collateral function of set-offs should be respected in bankruptcy proceedings in principle.

6.3.1.11 Avoidance

The Bankruptcy Act denies the effect of fraudulent or preferential transfers prior to the commencement of bankruptcy proceedings, restores property that has been disposed of or concealed, and ensures equal payment to creditors. The acts subject to avoidance are the concealment or disposition of property by the debtor considered as fraudulent conveyance, and preferential payment to specific creditors. The trustee is entitled to exercise the right of avoidance.

6.3.1.12 Dissolution procedures

Once the distribution of the bankruptcy estate is completed, a creditors' meeting is called to report the calculation. However, since creditors generally do not attend the meeting in practice, it is optional to attend and possible to report the calculation in writing.[89] If the trustee submits a written report of calculation, the court gives public notice, and if there are no objections from creditors within the prescribed period, the calculation is deemed to be approved. This terminates the bankruptcy proceedings. If the insolvent is a corporation and there are no remaining assets, it shall be extinguished by the trustee. If there are residual assets, such as property abandoned by the trustee, the corporation is deemed to still exist until a liquidator is appointed and liquidation takes place.

6.3.1.13 Groups of companies

Each corporation must file a separate petition for any insolvency proceedings. The court will consider each company individually. Substantive consolidation without the approval of the relevant creditors is not permissible under Japanese prevalent practice.

6.3.2 Special liquidation

In addition to bankruptcy proceedings, Japan has a simple liquidation-type insolvency procedure called special liquidation (*tokubetsu seisan*), which is governed by the Companies Act and only available to stock corporations. This may be utilised if it is discovered or believed

[87] *Idem*, art 55, para 2.
[88] *Idem*, art 67, para 1.
[89] *Idem*, art 89.

that the corporation has debts exceeding assets and is not able to complete a normal dissolution. Special liquidation is often used by parent companies to liquidate their subsidiaries in order to obtain tax benefits such as inclusion in deductible expenses of the release of claims. The debtor negotiates a settlement with each of its creditors individually, or has a payment plan accepted by each creditor individually with a minimum of two-thirds of the total claim amount and a majority of the headcounts, and confirmed by the court. In the event that the special liquidation is unsuccessful, bankruptcy will commence.

6.3.2.1 Commencement of special liquidation proceedings

Creditors, liquidators, auditors and shareholders are entitled to file for special liquidation.[90] Liquidators are obliged to file if there is a suspicion of insolvency.[91]

Grounds for commencement of special liquidation are (i) circumstances that would seriously impede the execution of liquidation and (ii) suspected excess of debt indicating an inability to pay one's debts in full with its assets.[92] Since this is a procedure for dissolved companies, insolvency[93] is not cause for commencement of special liquidation as it is in bankruptcy proceedings.

The court will dismiss the petition if the grounds for commencement are not proven, completion of special liquidation is clearly unlikely, it would clearly be contrary to the general interests of creditors, or the petition is filed in bad faith.[94] The typical case of being "contrary to the general interests of creditors" is when the bankruptcy procedure is expected to result in a larger distribution to creditors than the payment under the special liquidation agreement due to avoidance and other reasons.

In a special liquidation, all general creditors are compelled to participate in the proceedings, where they receive equal repayment. That means that individual execution by the creditors' side is prohibited or suspended.[95] Repayment to creditors is permitted unless there is a temporary restraining order prohibiting it,[96] but repayment during the period for creditors to submit claims is not permitted, except for the repayment of certain claims with the court's permission.[97]

In the repayment of general claims, it must be made proportionately to the amount of claims.[98] However, claims for expenses of the special liquidation proceedings, general statutory liens and other claims with general priority are not subject to the proceedings.[99] This is the same concept as in civil rehabilitation proceedings as further explained in paragraph 6.5.2.8, where the

90 Companies Act, art 511, para 1.
91 *Idem*, art 511, para 2.
92 *Idem*, art 510.
93 As mentioned in para 6.2.2.1, the term "insolvency" here refers to the debtor's lack of solvency and thus its general and continuous inability to pay its debts as they become due.
94 Companies Act, art 514.
95 *Idem*, art 515, para 1.
96 *Idem*, art 540, para 3.
97 *Idem*, art 500, paras 1 and 3.
98 *Idem*, art 537, para 1.
99 *Idem*, art 515, para 3.

procedural expenses and priority claims, which are similar to claims on the estate in bankruptcy, are taken out of the proceedings to protect the substantive position of priority creditors and simplify the proceedings by avoiding the classification of creditors at the resolution of the agreement.

In addition, to simplify the procedures, avoidance is not permitted since bankruptcy proceedings should commence if avoidance is necessary. On the other hand, set-off is prohibited as in bankruptcy proceedings.[100]

6.3.2.2 Liquidator

The most important role in special liquidation proceedings is played by the liquidator. Unlike trustees, liquidators are not particular to insolvency proceedings since they are part of the liquidation proceedings for all liquidating stock corporations.[101] They are charged with certain obligations and perform certain duties in special liquidation proceedings.

6.3.2.3 Agreement

Unlike distribution in bankruptcy proceedings, repayment to creditors is made based on an agreement accepted by resolution of a creditors' meeting and confirmed by the court. This allows for flexible revaluation and distribution in each case, which is a major advantage of special liquidation compared to bankruptcy.

The approval of an agreement requires a majority of the voting right holders present at the meeting and at least two-thirds of the total amount of claims.[102] When the agreement is executed and the special liquidation is completed, the court will issue a decision completing the process.[103]

Self-Assessment Exercise 4

Describe the priority among the claims related to bankruptcy proceedings.

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

There is no system of receivership in Japanese insolvency proceedings.

[100] *Idem*, arts 517 and 518.
[101] *Idem*, art 477, para 1.
[102] *Idem*, art 567.
[103] *Idem*, art 573.

6.5 Corporate rescue

6.5.1 Overview of corporate rescue regimes in Japan

Corporate rescue is the restructuring of a debtor's business without liquidating its legal entity. The reorganisation would be based on a restructuring plan that changes the rights of creditors and must be approved by creditors. In Japan, this group of proceedings is broken down into two different types: in-court proceedings and out-of-court proceedings.

Judicial proceedings are further broken down into two processes: civil rehabilitation proceedings and corporate reorganisation proceedings. Civil rehabilitation proceedings are mainly for small and medium-sized enterprises and basically led by a debtor as a debtor-in-possession, while corporate reorganisation proceedings are for larger corporations and controlled by a trustee as a management-type process.

Meanwhile, there are various procedural options for out-of-court workouts nowadays. The key features and each of these options will be elaborated in detail in paragraph 6.5.4.

6.5.2 Civil rehabilitation proceedings – in-court restructuring proceedings

6.5.2.1 Commencement of civil rehabilitation proceedings

Debtors and creditors are entitled to file petitions for civil rehabilitation proceedings.[104] A "creditor" here means a person who holds a rehabilitation claim that is subject to civil rehabilitation proceedings, and does not include any person who holds a claim that is not subject to such proceedings,[105] such as claims with general priorities, which is further explained in paragraph 6.5.2.8 (sub-heading *Claims with general priority*).

The court orders the commencement of civil rehabilitation proceedings when: (i) there is a possibility that any events involving the debtor constitute grounds for the commencement of bankruptcy proceedings, or (ii) the debtor is unable to pay any debts that are due without significantly impairing the continuation of the business.[106] Debtors may file a petition in either of these two cases, while creditors may file one only in the first case.[107]

A petition may be dismissed if: (1) the debtor has failed to prepay expenses for the civil rehabilitation proceedings, (2) there are pending bankruptcy or special liquidation proceedings and it is in the general interest of creditors to follow such proceedings, (3) it is clear that a proposed rehabilitation plan is unlikely to be prepared or approved, or a rehabilitation plan is unlikely to be confirmed, or (4) the petition for commencement of civil rehabilitation proceedings was filed for an improper purpose or not filed in good faith.[108]

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[104] Civil Rehabilitation Act, art 21.
[105] *Idem*, art 122, para 2.
[106] *Idem*, art 21, para 1.
[107] *Idem*, art 21, para 2.
[108] *Idem*, art 25.

6.5.2.2 Freezing the assets and ordering stays before the commencement of proceedings

Preservation of the debtor's current assets between the petition filing and the commencement of proceedings is more important than in liquidation-type bankruptcy proceedings so that the debtor can maintain the value of its business and succeed in its restructuring.

Firstly, to directly maintain the debtor's assets, the court may issue temporary restraining orders that, for example, prohibit the provisional seizure or disposal of the debtor's assets, the taking out of new loans, or the payment of rehabilitation claims.[109] Secondly, to generally restrict creditors from executing their rights, the court may order a stay of execution, a stay of judicial actions relating to the debtor's assets, or a stay of bankruptcy or special liquidation proceedings.[110] Furthermore, for secured creditors, the court may order a stay of enforcement on their security interests.[111]

6.5.2.3 Moratoriums and stays upon the commencement of proceedings

An order of commencement of civil rehabilitation proceedings has the same general effect as an order of commencement of bankruptcy proceedings. Upon commencement of civil rehabilitation proceedings, the repayment of rehabilitation claims is basically prohibited.[112] However, there are certain exceptions where the debtor is permitted to repay certain claims once the proceedings have commenced, subject to the court's permission. One is the repayment of small claims.[113] Early payment of such claims can reduce the number of creditors and facilitate civil rehabilitation proceedings, but failure to pay those claims may significantly impede the continuation of the debtor's business, especially when such transactions are essential for that business.

6.5.2.4 Roles of key players

Supervisor

When a petition for civil rehabilitation proceedings is filed, the court may, if necessary, order supervision by a supervisor.[114] In general practice, a supervisor is appointed in all cases and they are generally attorneys in most of them. The supervision order specifies acts that the rehabilitation debtor may not conduct without the consent of the supervisor. In such cases, acts conducted without the supervisor's consent shall be void; provided, however, that this may not be asserted against third parties that have acted in good faith.[115] Supervisors also have a duty to supervise the rehabilitation debtor's execution of the rehabilitation plan. The supervisor's

[109] *Idem*, art 30.
[110] *Idem*, art 26.
[111] *Idem*, art 31. However, since secured creditors have priority under substantive laws and particularly need to be protected as they are securing collateral in preparation for the insolvency of the debtor, more stringent requirements must be met in order to stay the execution of their security interests than to stay the execution of general claims.
[112] *Idem*, art 85, para 1.
[113] *Idem*, art 85, para 5.
[114] *Idem*, art 54.
[115] *Idem*, art 54, para 4.

authority is mainly the right to consent and to receive reports, as well as, one step removed, looking after the rehabilitation debtor who is taking the lead in the proceedings as a debtor-in-possession. In addition, supervisors have the authority to conduct investigations; request reports from directors and employees of the corporate debtor, as well as subsidiaries, regarding the status of business and property; and inspect books, documents and other materials.[116]

Investigator

When the court determines whether the proceedings shall commence, or whether to confirm the rehabilitation plan, it may have a third-party investigator collect and report sufficient information when it cannot do so from the debtor alone. In practice, a supervisor is generally appointed as mentioned above, so the appointment of an investigator is limited to exceptional cases since the supervisor already has the same authority to investigate and the same reporting obligations. If, for example, a creditor files a petition and does not have sufficient information on the debtor's financial situation, then an investigator would be appointed to investigate the facts to determine whether the proceedings should commence.

Trustee

The most distinctive feature of civil rehabilitation proceedings is that they are debtor-in-possession-type (DIP-type) proceedings. However, some cases may not be suitable for pursuing these proceedings in light of the interests of creditors, such as when any aspects of the rehabilitation debtor's management and disposal of property or conduct of business are found to be unreasonable. In such cases, civil rehabilitation proceedings are exceptionally managed as management-type proceedings, and the debtor's right to administer and dispose of property and conduct business is vested exclusively in a trustee like in bankruptcy proceedings.[117]

6.5.2.5 Post-commencement financing / DIP financing

DIP financing claims made after filing for civil rehabilitation proceedings are considered as "common benefit claims" (*kyoeki saiken*) if the court permits, or a supervisor approves or consents to, the DIP financing.[118] As further explained in paragraph 6.5.2.8 (sub-heading *Common benefit claims*), since common benefit claims must be repaid ahead of other unsecured claims during the civil rehabilitation process, it is comparable to converting unsecured claims into administrative expenses. However, there are no systems, such as the super priority or priming lien found in US Chapter 11, that allow DIP financing claims to be prioritised over all other administrative expenses or existing liens.

6.5.2.6 Sale of the debtor's business

Court permission is required for transferring the entire or a significant part of the operation or business of the debtor.[119] This permission is granted only when the court finds it necessary for

[116] *Idem*, art 59.
[117] *Idem*, art 66.
[118] *Idem*, art 119, item 5.
[119] *Idem*, art 42, para 1.

the restructuring of the business. Specifically, such necessity is recognised when it is essential for the restructuring and continuation of the remaining business to obtain funds through a transfer of the business to a third party, which is more advantageous to the creditors and employees.

6.5.2.7 Investigation of claims

A creditor that wishes to participate in civil rehabilitation proceedings must file with the court a proof of the nature and cause of its claim, the amount of voting rights, and the amount of expected deficiency in collateral within the period for filing proofs of claims specified in the commencement order.[120] With regard to rehabilitation claims that have not been filed, unless the rehabilitation creditor acknowledges the existence of the debt, it may not participate in the proceedings.

6.5.2.8 Classification of claims

Rehabilitation claims

Rehabilitation claims (*saisei saiken*) are defined as "claims on property arising from causes prior to the commencement of civil rehabilitation proceedings against the debtor."[121] They cannot be exercised upon commencement of civil rehabilitation proceedings and are subject to modification of rights in a rehabilitation plan.

Common benefit claims

Claims for the common benefits of rehabilitation creditors, especially those that arise after the commencement of civil rehabilitation proceedings, are considered "common benefit claims" (*kyoeki saiken*), and priority will be given to them for payment at any time. It is a similar concept to administrative expenses in the US and equivalent to claims on the estate in bankruptcy proceedings, which was explained in paragraph *6.3.1.7* (sub-heading *Claims on the estate*).[122]

Typical common benefit claims are:

(1) the debtor's business and living expenses after the commencement of proceedings and expenses for the management and disposition of property;

(2) expenses for the execution of a rehabilitation plan;

(3) claims arising from borrowing of funds by the debtor after the commencement of proceedings;

[120] *Idem*, art 94.
[121] *Idem*, art 84, para 1.
[122] *Idem*, art 119.

(4) claims arising from indispensable acts for the continuation of the debtor's business such as borrowing of funds and purchase of raw materials prior to the commencement of proceedings with the court's permission or the supervisor's approval; [123] and

(5) claims of other debtors in cases where one of them has assumed an unexecuted bilateral contract.[124]

Claims with general priority

Claims with a general statutory lien or other general priority under the substantive law are called "claims with general priority" (*ippan yusen saiken*). The typical examples are wage claims and tax claims. They are repaid at any time outside civil rehabilitation proceedings like common benefit claims,[125] while bankruptcy proceedings incorporate these kinds of claims into the proceedings themselves and treat them as preferred bankruptcy claims, as mentioned in paragraph 6.3.1.7 (sub-heading *Bankruptcy claims*). This treatment enables the civil rehabilitation proceedings to have only one class of general rehabilitation creditors who vote on a proposed plan, resulting in a simplified process in accordance with the purpose of having simple and prompt civil rehabilitation proceedings for small and medium-sized enterprises.

Post-commencement claims

Post-commencement claims are claims other than common benefit claims, claims with general priority, or rehabilitation claims that are due after the commencement of civil rehabilitation proceedings.[126] In practice, however, these claims are unlikely to arise. They are repaid after the payment made based on a restructuring plan, but they are not effected by the rehabilitation plan nor are the rights modified by it.

6.5.2.9 Collateral – separate satisfaction

In civil rehabilitation proceedings, security interests such as mortgages and special liens are treated as rights of separate satisfaction,[127] which is a major feature of these proceedings. This is the same as in bankruptcy proceedings, as explained in paragraph 6.3.1.8, and differs from corporate reorganisation proceedings where security rights are incorporated into the proceedings themselves, referred to further in paragraph 6.5.3.7 (sub-heading *Secured claims*). In civil rehabilitation proceedings, which are intended for small and medium-sized enterprises, the system of valuation of the collateral and resolution based on classification should not be adopted to simplify the proceedings. In practice, the debtor and secured creditors often agree on the collateral's value, its repayment schedule, and, to the degree that such repayment is properly fulfilled, an enjoinment in respect of enforcement.

[123] *Idem*, art 120, para 1.
[124] *Idem*, art 49, para 4.
[125] *Idem*, art 122.
[126] *Idem*, art 123, para 1.
[127] *Idem*, art 53.

6.5.2.10 Executory contracts

Treatment of executory contracts in civil rehabilitation proceedings[128] is essentially parallel to and basically the same as that in the Bankruptcy Act, as explained in paragraph 6.3.1.9.

6.5.2.11 Set-off and netting

The right of set-off is guaranteed in restructuring-type proceedings as well as in liquidation-type proceedings, as mentioned in paragraph 6.3.1.10. However, the set-off must be completed within a certain timeframe[129] since the amount and other details of claims and debts must be determined as early as possible in order to formulate a plan in restructuring-type proceedings.

6.5.2.12 Avoidance

Avoidance under the Civil Rehabilitation Act[130] is essentially parallel to and basically the same as that in the Bankruptcy Act, which is already explained in paragraph 6.3.1.11.

6.5.2.13 Rehabilitation plan

Details of the plan

A rehabilitation plan may stipulate various clauses but it must at least stipulate those modifying the rights of rehabilitation creditors, those concerning payment of common-benefit and general-priority claims, and those detailing post-commencement claims.[131]

As for the modification of rights, the rehabilitation plan must treat those rights uniformly amongst the rehabilitation creditors.[132] Particularly, in civil rehabilitation, unlike corporate reorganisation, all claims that are subject to the plan are consolidated into rehabilitation claims, and neither priority nor subordinated claims exist in the modification, so basically all the claims must be treated equally. However, special treatment may be allowed in the following exceptional cases:[133]

(1) when the creditors consent that their claims are treated adversely;

(2) to treat small claims favourably or to treat claims for interest and damages after the commencement of proceedings[134] unfavourably. Since small claims may be paid at any time during the proceedings,[135] there is no problem with treating them favourably in the

[128] *Idem*, art 127.
[129] *Idem*, art 92.
[130] *Idem*, art 127.
[131] *Idem*, art 154, para 1.
[132] *Idem*, main clause of art 155, para 1.
[133] *Ibid*.
[134] *Idem*, art 84, para 2.
[135] *Idem*, art 85, para 5.

plan. Interest and damages claims are considered to be subordinated in bankruptcy proceedings, and it is considered rather fair to make them substantially subordinated; and

(3) when a difference between creditors would not prejudice equity. For example, a creditor who is a shareholder or director of the debtor and is responsible for the insolvency may be treated unfavourably and their claim may be treated as subordinate to the rehabilitation debtor's claim.

Voting on the plan

When a proposed rehabilitation plan is submitted, the court makes an order to refer it to a rehabilitation creditors' meeting for its resolution. In order for the plan to be approved, the following must be in favour of it: (1) a majority of the voting right holders present and (2) at least one half of the total voting rights enacted.[136]

Confirmation of the plan

If the proposed rehabilitation plan is approved by the creditors, the court orders a confirmation or disconfirmation of the plan. Minimum requirements for confirmation must be satisfied to protect the rights of dissenting creditors. The court must issue an order of confirmation if there are no grounds for disconfirmation,[137] or an order of disconfirmation if there are any grounds,[138] leaving the court with no discretion.

Grounds for disconfirmation include: (1) serious violation of the law in the civil rehabilitation proceedings or plan, (2) lack of prospects for implementation of the plan, (3) unlawful means taken in the resolution of the plan, and (4) incompatibility of the plan with the general interests of rehabilitation creditors. Instance (4) is where a rehabilitation creditor expects to receive a larger repayment in bankruptcy proceedings. In this case, even if a majority of creditors agree to accept a rehabilitation plan with less payment, the plan should be disconfirmed in order to protect the interests of minority dissenting creditors. This is called the principle of guaranteeing liquidation value.

A rehabilitation plan becomes effective when an order of confirmation becomes final and binding.[139] The rights of filed rehabilitation and self-approved claims shall be modified in accordance with the provisions of the rehabilitation plan.[140] In addition, the debtor shall basically be discharged from liability for all rehabilitation claims, except for rights approved pursuant to the provisions of the rehabilitation plan.[141]

[136] *Idem*, art 172-3, para 1.
[137] *Idem*, art 174, para 1.
[138] *Idem*, art 174, para 2.
[139] *Idem*, art 176.
[140] *Idem*, art 179.
[141] *Idem*, art 178.

6.5.2.14 Transition to bankruptcy

If the civil rehabilitation proceedings are terminated for any reason before they are completed, new bankruptcy proceedings are basically initiated by the court's authority.[142] These proceedings begin as a different procedure but various aspects of the previous civil proceedings are utilised to simplify and effectuate the process.

First, common benefit claims in civil rehabilitation proceedings are treated as claims on the estate in bankruptcy proceedings.[143] Therefore, DIP financing provided in civil rehabilitation proceedings are guaranteed priority even if they are transferred to bankruptcy proceedings. If a proof of claim has already been filed in the civil rehabilitation proceedings, it can also be used in the subsequent bankruptcy proceedings.[144]

6.5.2.15 Shorter forms of civil rehabilitation proceedings

The typical duration of a civil rehabilitation case is around five months, according to the Tokyo District Court's standard timetable. However, the length of any case will ultimately rely on its intricacy and circumstances. To accelerate and simplify the proceedings, the Civil Rehabilitation Act offers two shorter forms: simplified rehabilitation proceedings and consensual rehabilitation proceedings.

In simplified rehabilitation proceedings, debtors can skip the process of examining and determining creditors' claims with the consent of 60% or more of the creditors who have filed claims.[145] This results in the proceedings' completion within one to two months. Recently, this shorter form was used as a tool for a debtor who failed to obtain unanimous consent in an out-of-court workout of Turnaround ADR to quickly effectuate the restructuring plan proposed in the preceding workout, which will be explained in paragraph 9.1. This enabled the debtor to cram down the minority lenders who opposed its restructuring plan.

In consensual rehabilitation proceedings, a special procedure is used when the debtor has already obtained the consent of all rehabilitation creditors. The debtor may skip not only the investigation of claims but also the resolution of a proposed rehabilitation plan.[146] This procedure is sometimes used as an ultra-quick method of obtaining the court's approval when the parties have already reached an agreement outside of court.

6.5.2.16 Group companies

As mentioned in paragraph 6.3.1.13, each corporation must file a separate petition for any insolvency proceedings. The court will consider each company individually. Substantive consolidation without the approval of the relevant creditors is not permissible under prevalent Japanese practice.

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[142] *Idem*, art 250, para 1.
[143] *Idem*, art 252, para 6.
[144] *Idem*, art 253.
[145] *Idem*, art 211.
[146] *Idem*, art 217.

6.5.3 Corporate reorganisation proceedings – in-court restructuring proceedings

6.5.3.1 Overview of corporate reorganisation proceedings

Corporate reorganisation proceedings (*kaisha kosei*), another form of in-court restructuring-type insolvency proceedings governed by the Corporate Reorganisation Act, have a process similar to that of civil rehabilitation proceedings, although there are some key differences as follows.

Firstly, corporate reorganisation proceedings are available only for stock corporations,[147] with some exceptions granted to financial institutions that are not stock corporations. Various other corporate forms, such as unlimited partnerships, limited partnerships and limited liability corporations cannot use these proceedings.

Secondly, these are management-type proceedings in which a trustee is appointed in every case, compared to civil rehabilitation proceedings which are basically DIP-type proceedings. A trustee takes over possession and control of the debtor's business and assets like in bankruptcy proceedings. Transparency of procedures is ensured by having an independent third party as the trustee.

Thirdly, corporate reorganisation proceedings prohibit secured creditors from exercising their secured interests and modify their rights in the reorganisation plan. Compared to civil rehabilitation proceedings, in which secured creditors can exercise their rights outside the proceedings as the right of separate satisfaction as mentioned in paragraph *6.5.2.9*, corporate reorganisation proceedings strengthen the restrictions on security interests that may hinder reorganisation.

In general, the entire corporate reorganisation procedure requires considerable time, cost and effort due to its tighter restrictions. The provisions unique to the reorganisation proceedings will be focused on further here.

6.5.3.2 Filing for corporate reorganisation proceedings

With regard to petitioners, the debtor can file a petition, and creditors who can file are limited to those who have claims that account for one-tenth or more of their capital.[148] The law also allows shareholders who hold one-tenth or more of the voting rights of all shareholders to file for corporate reorganisation proceedings.[149]

6.5.3.3 Commencement of corporation reorganisation proceedings

The order of commencement of corporate reorganisation proceedings includes the appointment of a trustee who manages and controls the debtor's business and assets. There are some additional characteristics due to the large scale of the proceedings for stock corporations.

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147 Corporate Reorganisation Act, art 1.
148 *Idem*, art 17, para 2, item 1.
149 *Idem*, art 17, para 2, item 2.

Firstly, the execution of security interests is prohibited by a commencement order, unless the prohibition is lifted, and the execution of tax claims is also prohibited to a certain extent. Secondly, changing the basic organisational structures of the debtor is also prohibited,[150] such as offering of shares or bonds, distribution of dividends, corporate split, merger, share exchange, share transfer and capital reduction. During the reorganisation proceedings, these acts must always be conducted through the reorganisation plan. Furthermore, the substantial duties of directors are extinguished because the right to manage the business is transferred to the trustee. As a result, remuneration of directors may not be claimed during the proceedings.[151]

6.5.3.4 Trustee

In corporate reorganisation proceedings, a trustee is always appointed.[152] The powers and duties of the trustee in corporate reorganisations are basically the same as those of the trustee in bankruptcies or civil rehabilitations. The authority to manage the debtor's business and dispose of property belongs exclusively to the trustee.[153]

However, there are two aspects unique to reorganisation trustees. Firstly, after an order of approval of the reorganisation plan is made, it is possible to return the business management rights to the original management, such as directors and executive officers, in accordance with the reorganisation plan or by court order.[154] Thereafter, the trustee supervises the debtor's business management.[155] Secondly, trustees are subject to a non-compete obligation.[156]

6.5.3.5 Meeting of interested parties

As a body equivalent to a creditors' meeting in bankruptcy or civil rehabilitation proceedings, a meeting of interested parties is established in reorganisation proceedings. This meeting has a more diverse composition, reflecting the fact that the interested parties in reorganisation proceedings include not only general creditors but also secured creditors and shareholders. Therefore, the debtor, reorganisation creditors, secured creditors and shareholders must be summoned to the meeting in addition to the trustee.[157] Further, a resolution on the proposed reorganisation plan at the interested parties' meeting is made for each group based on the classification of groups so that the opinions of the various interested parties can be accurately reflected, which is explained in paragraph 6.5.3.10.

6.5.3.6 Shareholders

Unlike in civil rehabilitation proceedings, shareholders may participate in reorganisation proceedings.[158] However, their right to participate differs completely depending on whether the

[150] *Idem*, art 45.
[151] *Idem*, art 66.
[152] *Idem*, art 42, para 1.
[153] *Idem*, art 72, para 1.
[154] *Idem*, first sentence of art 72, para 4.
[155] *Idem*, second sentence of art 72, para 4.
[156] *Idem*, art 79.
[157] *Idem*, art 115, para 1.
[158] *Idem*, art 165.

reorganised company is unable to pay its debts in full with its assets upon commencement of the proceedings. In other words, if the company is not insolvent, shareholders have one voting right per share[159] and can exercise other procedural rights. In the case of a business transfer outside the reorganisation plan, shareholders holding one-third of the voting rights also have veto rights.[160]

However, if the reorganised company is insolvent, as is usually the case, the rights of shareholders are greatly restricted. Shareholders have no voting rights[161] and, in the case of a business transfer, they are not allowed to veto the transfer or even have their opinions heard. Furthermore, it is not necessary to notify shareholders of the decision to initiate proceedings.[162] Since shareholders of an insolvent company are not allowed to have voting rights, this is intended to reduce the unnecessary cost and effort of notifying a large number of shareholders. In addition, shareholders of an insolvent company basically may not file an immediate appeal against the confirmation or disconfirmation of the reorganisation plan.[163] The purpose of this provision is to prevent abusive appeals. Thus, the law significantly restricts the rights of shareholders in cases of insolvency, taking into consideration their real economic status of having no equity in the company.

6.5.3.7 Classification of claims

Reorganisation claims

Reorganisation claims are defined as "claims on property against the debtor arising from causes prior to the commencement of corporate reorganisation proceedings" and claims for interest and compensation for damages after the commencement of proceedings.[164] Amongst reorganisation claims, those with general statutory liens or other general priority rights are treated as preferred reorganisation claims and given priority in the proceedings.[165] This differs from civil rehabilitation proceedings, in which these claims are treated as general priority claims and taken out of the proceedings, which is basically the same as in bankruptcy proceedings. This is because corporate reorganisation proceedings assume a resolution by classification, and it is possible and appropriate to treat priority claims separately from general reorganisation claims in the proceedings.

Secured claims

The most distinctive feature of corporate reorganisation proceedings is the incorporation of secured creditors into the proceedings and the restriction of exercise of their security interests, which makes it possible to modify those rights in the reorganisation plan. Secured claims cannot

[159] *Idem*, art 166, para 1.
[160] *Idem*, art 46, para 7, item 2.
[161] *Idem*, art 166, para 2.
[162] *Idem*, art 43, para 4, item 2.
[163] *Idem*, art 202, para 2, item 2.
[164] *Idem*, art 2, para 8.
[165] *Idem*, art 168, para, item 2.

be repaid once the proceedings have commenced,[166] and the exercise of security interests is prohibited or suspended.[167]

Common benefit claims

Corporate reorganisation proceedings have a concept of common benefit claims similar to that in civil rehabilitation proceedings, as explained in paragraph 6.5.2.8 (sub-heading *Common benefit claims*). The scope of common benefit claims in corporate reorganisation proceedings is also basically the same as that in civil rehabilitation proceedings.[168] However, some claims that are not treated as common benefit claims in civil rehabilitation proceedings are recognised as common benefit claims in reorganisation proceedings, such as tax claims and wage / severance claims to certain extent.

6.5.3.8 Sale of the debtor's business

Business transfers are subject to the court's approval like in civil rehabilitation proceedings.[169] There is a great need to promptly transfer a business during the proceedings for the purpose of reorganisation as well.

Since the authority to manage the debtor's business and dispose of property is fully transferred to the trustee in reorganisation proceedings,[170] a special resolution of the shareholders' meeting[171] is not required for the business transfer, but since the business transfer will undoubtedly have a substantial and material impact on shareholders' interests, a special veto right is to be granted to shareholders. The trustee notifies shareholders of and publicly announces the details of the business transfer,[172] and if any shareholders holding more than one-third of the total number of voting rights give written notice of their intention to oppose the transaction, the court cannot permit the business transfer.[173] However, if the debtor is insolvent, such procedure is considered unnecessary because the shareholders have no substantial equity interests[174] and, as a result, in many cases, it is actually possible to transfer the business without even hearing the opinions of the shareholders.

6.5.3.9 Reorganisation plan

As a feature of the modification of rights by the reorganisation plan, a fair and equitable distinction must be made between the different types of rights holders since a variety of related parties are subject to the reorganisation proceedings. Namely, amongst secured claims, preferred claims, general reorganisation claims, contractually-subordinated claims, preferred shares and common shares, the order of their rights under the substantive law should be taken

[166] *Idem*, art 47, para 1.
[167] *Idem*, art 50, para 1.
[168] *Idem*, art 127 for main examples.
[169] *Idem*, art 46.
[170] *Idem*, art 72, para 1.
[171] Companies Act, arts 467 and 309, para 2, item 11.
[172] Corporate Reorganisation Act, art 46, para 4.
[173] *Idem*, art 46, para 7, item 2.
[174] *Idem*, art 46, para 8.

into consideration.[175] This reflects the fairness and equity of the plan in the confirmation requirements. On the other hand, the same class of rights holders must be treated in a substantively equal manner.[176]

One of the main features of the reorganisation plan is that it may include provisions on matters that would normally require a resolution of a shareholders' or board of directors' meeting to take such actions,[177] and if the plan is approved, such matters may be subject to the reorganisation proceedings and the plan itself will take effect without going through the normal procedures such as holding a shareholders' meeting under the Companies Act.

6.5.3.10 Voting on the plan

In principle, a resolution on a proposed reorganisation plan is adopted for each different type of rights holder,[178] but the court, at its discretion, may consolidate or divide each group.[179] In practice, preferred creditors and general reorganisation creditors are often placed in the same group. The requirements for approval differ for each group.

Firstly, reorganisation creditors require consent based on more than half of the total voting rights.[180]

Secondly, with regard to secured creditors, it is more complicated, but (i) consent based on at least two-thirds of the total voting rights is required for extending the term, (ii) three-quarters consent is required for modifying certain rights such as reduction or exemption, and (iii) nine-tenths consent is required for the proposed liquidation-type reorganisation plan.[181]

Finally, regarding shareholders, consent based on a majority of the total voting rights is required.[182] However, in the case of insolvency, shareholders are not allowed to have voting rights.

Compared to civil rehabilitation proceedings, this procedure is unique in that it does not have to meet a headcount requirement due to the capital nature of stock corporations, and that it has particularly strict approval requirements for secured creditors, who need substantial protection.

6.5.3.11 Adoption of the reorganisation plan and completion of the proceedings

Due to the characteristic of reorganisation proceedings that the resolution of the proposed reorganisation plan is made on a class basis, a situation may arise in which some groups approve the plan but others do not. In such cases, the court may decide to approve the proposed

[175] *Idem*, art 168, para 3.
[176] *Idem*, art 168, para 1.
[177] *Idem*, art 174.
[178] *Idem*, art 196, para 1.
[179] *Idem*, art 196, para 2.
[180] *Idem*, art 196, para 5, item 1.
[181] *Idem*, art 196, para 5, item 2.
[182] *Idem*, art 196, para 5, item 3.

reorganisation plan by modifying it or by stipulating provisions to protect the rights of the dissenting groups,[183] like the cram-down.

Once the reorganisation plan is approved, a modification of rights is effected in accordance with the provisions of the plan,[184] and all rights of secured claims, reorganisation claims and shareholders who have not filed notifications are discharged and extinguished.[185]

Corporate reorganisation proceedings are completed when (i) the reorganisation plan has been executed, (ii) execution of the plan is deemed certain, or (iii) no default has occurred in executing it when at least two-thirds of the total monetary claims approved under the plan have been paid.[186]

6.5.4 Out-of-court proceedings for corporate rescue

6.5.4.1 Introduction

As mentioned in paragraph 6.1.1.2, Japan has several forms of rule-based out-of-court workouts in which participants must follow particular rules, guidelines or laws while the restructuring is supervised by independent specialists. All of them limit the participating creditors, whose rights are modified in the process, mainly to financial institutions such as banks, whose aim is to standardise the workout process and help facilitate the negotiations between distressed debtors and their financial institution creditors. In other words, these workouts function as preliminary insolvency proceedings for debtors that can maintain their cash liquidity to continue their businesses by requesting standstill and debt restructuring only to the banks without suspending the payments to other trade creditors. Nowadays, these regimes are common restructuring tools in Japan due to the benefits mentioned in paragraph 6.5.4.2 (sub-heading *Advantages*).

Each type of workout has common steps based on the rules: (i) multiple creditors' meetings would be held for discussing the restructuring while debtors draft a restructuring plan, and (ii) the parties aim for unanimous approval of the restructuring plan in the end. These types of workouts preserve the benefits of out-of-court proceedings while overcoming their general drawbacks.

While debtors can negotiate the rescheduling of repayments with the financial institution creditors purely without these rule-based workouts, it is difficult for such creditors in practice to agree with the significant debt restructuring without the recognised standards of out-of-court workouts.

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[183] *Idem*, art 200, para 1.
[184] *Idem*, art 205.
[185] *Idem*, art 204.
[186] *Idem*, art 239.

6.5.4.2 Advantages and disadvantages of rule-based out-of-court workouts

Advantages

Private (maintains the going-concern value): An out-of-court workout may be processed privately, typically with only financial creditors, particularly banks, not trade creditors, unless it is an exceptional case where the process must be disclosed to the public, such as when the debtor is a publicly traded company. Conversely, court procedures are public in general. It is more beneficial for debtors to preserve the going-concern value, whereas an announcement of in-court insolvency proceedings causes a huge concern or harmful rumours in a debtor's distressed situation among its creditors and customers, who may even terminate existing transactions with the debtor or change the terms and conditions to unbeneficial ones as a result. The more going-concern value can be kept in workouts, the more assets can be distributed in the restructuring. Consequently, it also benefits financial creditors eventually.

Simpler / less complex: The workout is simpler and can be flexible since the process is based on the unanimous approval and consent of creditors. Neither judges nor trustees need be appointed to start an informal reorganisation. On the other hand, the court proceedings require various individual procedures under the law such as the investigation of claims and the submission of documents to the court and notices to creditors. This guarantees due process; in other words, to legitimise the procedures which force the claims to be discharged based on a restructuring plan with a majority vote. Furthermore, since the court and officeholders such as the trustee must be involved in the in-court proceedings, the process is more complex than a workout.

Transparent and foreseeable: As stated above, the main aspect of out-of-court workouts is the unanimity of all interested creditors (not legally binding without their consent), while court proceedings conform to the legal provisions. This flexibility of the former reduces transparency of the process, whereas the latter calls for more disclosure of the claims and the debtor's financial status. Since the court is not overseeing the workout, creditors question the fairness of the process and equal treatment among them especially on repayment under a restructuring plan. To overcome these drawbacks, the guidelines and rules stipulate the steps to be taken during the out-of-court workout. They were formed by the representatives of financial institutions, experts and academics. Though not legally binding, they should be respected and followed by parties engaging in the workout. This improves the transparency and foreseeability of the process for the parties.

Fairer / more equal: In addition to conforming to the rules, as neutral experts would review the proceedings and the restructuring plan, the process can be more objective than when only a debtor and its concerned creditors handle a workout.

Faster resolution: Due to the above-mentioned simpler approach, typically, out-of-court restructurings often take less a year, sometimes six to 10 months, while in-court proceedings may take longer to complete. This implies that a debtor firm can successfully restart its business sooner following the restructuring.

Less costly than court procedures: Another effect of the simpler process is that, in general, out-of-court proceedings are far less expensive than in-court proceedings, which necessitate court-related expenses such as the deposit or the trustee's fee. Attorney's fees also typically tend to run higher in court proceedings. Although the rule-based out-of-court workouts require third parties to be involved, they are still less expensive than in-court proceedings.

Tax benefits for creditors: Creditors are permitted to include the costs in deductible expenses for tax reasons if they waive their claims based on a restructuring plan in compliance with the requirements of rule-based workouts. This is done to provide creditors in out-of-court workouts with the same advantages as court proceedings.

Protection of management (the guarantor) for the next step: In Japan, the guidelines for debt workouts of company managers' guarantee obligations stipulate the cases where management such as directors may be protected such that they do not have to file a bankruptcy for the personal liability of guarantee against the corporate creditors and can maintain their residences or other incentive assets if they comply with the requirements. This guideline can be used even when a corporate debtor files a court procedure, but the protection tends to be easier to be approved by creditors in a workout process if the corporate restructuring plan is consented to unanimously. The guideline serves to safeguard the management, especially if they share less of the blame for the insolvency, and to encourage the making of restructuring decisions more quickly.

Grace period for delisting: Turnaround ADR, one of the five rule-based workouts explained in paragraph 6.5.4.3 (sub-heading *Turnaround ADR (Alternative Dispute Resolution)*), is a suitable procedure for larger enterprises like listed companies. This type of workout does not trigger delisting, unlike with court restructuring procedures. Normally, a company is subject to delisting if it has been in a state of insolvency for two consecutive fiscal years, according to the Tokyo Stock Exchange Listing Regulations. However, if the insolvency is expected to be resolved through Turnaround ADR, the grace period for delisting will be extended by one year.

Disadvantages

Need of unanimous approval: Since unanimous consent by all creditors is required for binding them to the restructuring plan, it is more difficult to approve the plan in a workout, as opposed to court restructurings where the plan would be authorised by vote.

No standstill to trade creditors: A standstill during the workout could prevent finance creditors from collecting loan principal. Trade creditors, however, normally do not participate in the workout. Therefore, if a debtor is experiencing urgent problems with its ability to repay its commercial creditors, it may not be able to survive until the completion of the workout and will likely need to move into court proceedings to legally stop repayment.

6.5.4.3 Brief explanation of each proceeding

Turnaround ADR (alternative dispute resolution)

This procedure was established under the present Act on Strengthening Industrial Competitiveness. The process is supervised by experts, usually attorneys, who are selected as "operators" by the Japanese Association of Turnaround Professionals (JATP), which is a private organisation certified under the Act on Promotion of Use of Alternative Dispute Resolution. These operators preside over the process and review the proposed restructuring plan. Turnaround ADR mainly targets medium-sized to large companies including global enterprise groups with foreign subsidiaries due to the higher procedure fees than the next type of proceeding, the Councils scheme. Therefore, the number of international restructuring cases using this method has been rapidly increasing.

Small and Medium-Sized Enterprise Revitalization Councils

The Small and Medium-Sized Enterprise Revitalization Councils (the Councils), a public institution, was established under the present Act on Strengthening Industrial Competitiveness. It supports the workout process and organises a review committee to assign the examination of the proposed restructuring plan from an objective standpoint. This framework is used rather by small and medium-sized enterprises that have 300 or fewer employees and capital of JPY 300 million or less, with the actual size requirement depending on the debtor's industry. The procedure is less expensive than others as there is no fee for the Councils, and the due diligence may be partly subsidised by the government.

Rehabilitation-type out-of-court workouts for small and medium-sized enterprises

This type of workout was newly adopted in 2022 under the Guidelines for Restructuring of Small and Medium Enterprises. Distressed debtors using this scheme would appoint third-party supporting experts such as lawyers from the public list of accredited experts, with the consent of major creditors, to examine whether the proposed restructuring plan is fair. This scheme also focuses on small and medium-sized enterprises, but the difference between it and the Councils is that the debtors must choose the third-party experts and that the legal fees for the attorneys representing the debtor may be partly subsidized by the government in addition to the cost of due diligence.

Regional Economy Vitalization Corporation of Japan (REVIC)

REVIC is an organisation established under the Regional Economic Revitalisation Corporation Act that proactively takes the lead in restructuring small and medium-sized enterprises with 1,000 or fewer employees and capital of JPY 500 million or less, with some exceptions. REVIC itself conducts due diligence of the debtor, formulates its restructuring plans and co-ordinates the interests of financial institutions and other stakeholders as a neutral and fair third-party organisation, unlike the third parties in the three methods explained above which review the plan formulated by the debtor. Thus, the fee is generally the most expensive among the options explained in this section. REVIC is unique in that (i) it is a governmental organisation and (ii) it

has the following functions: investment, lending of capital, guarantee of financial obligations, turnaround staffing, and debt purchasing.

Special conciliation

Special conciliation is a proceeding governed by the Act on Special Conciliation for Expediting Arrangement of Specified Debts, where debtors who are about to be insolvent may settle on the payment conditions of their financial debts with their creditors under mediation in a summary court. It involves a court mediator, but unlike in-court insolvency proceedings, special conciliation basically requires the individual and active consent of all creditors to the settlement. If the settlement is not agreed in the mediation, the court may make an order, and if there is no objection to the order, it becomes effective. The court's involvement gives transparency and fairness among creditors in the process compared to the other rule-based workouts. Special conciliation is originally more common as a consumer insolvency process as explained in paragraph 6.2.4, and thus it is a rather less common method of corporate rescue.

6.5.4.4 Potential future developments

Unanimous consent by all creditors is required for binding them creditors to the restructuring plan in out-of-court insolvency proceedings in Japan, while the restructuring or reorganisation plan can be voted on and approved basically by a majority of the creditors in civil rehabilitation or corporate reorganisation proceedings. As of 2023, the Japanese government is considering the adoption of new out-of-court workout legislation, under which a restructuring plan will be legally binding if it receives a majority of the creditors' votes and court confirmation, as explained further in paragraph 9.1.

Self-Assessment Exercise 5

What are the advantages and disadvantages of the Japanese rule-based out-of-court insolvency proceedings?

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

7.1 Introduction of Japanese cross-border insolvency laws

Japan had long followed a strict territoriality concept until it adopted the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) in 2001. Insolvency procedures initiated in Japan did not extend to the debtor's assets located outside the country, while insolvency proceedings initiated abroad also did not extend to the debtor's assets located domestically. However, between 1999 and 2000, this concept was repealed, and the extraterritoriality principle was

instituted in its stead. As a result, current Japanese law extends the power of the trustee or debtor-in-possession to the debtor's assets located outside of Japan.

Furthermore, in 2001, Japan enacted the Act on Recognition of and Assistance for Foreign Insolvency Proceedings (the Recognition and Assistance Act) (Act No 128 of 2000) based on the Model Law. The Recognition and Assistance Act establishes measures to extend foreign insolvency proceedings to the debtor's assets in Japan and regulates Japanese international insolvency law. This country was one of the earliest to adopt the Model Law. The Recognition and Assistance Act not only accepted the Model Law, but it made various changes to it. As a result, Japan has recognised 21 foreign insolvency proceedings as of 2021.

Cross-border insolvency laws in Japan consist of two parts. The first is the stand-alone Recognition and Assistance Act, which governs the recognition and assistance process of foreign insolvency proceedings. The second is incorporated into each insolvency procedural law such as the Civil Rehabilitation Act and Bankruptcy Act, which mainly stipulate the international insolvency jurisdictions for all Japanese proceedings, mutual co-operation amongst trustees (or the debtor in civil rehabilitation proceedings) in parallel insolvency proceedings in multiple countries, and the principle that domestic proceedings are effective on the debtor's property in those countries.

7.2 Differences from the Model Law

As mentioned, Japan adopted the Model Law in 2001, and enacted the Recognition and Assistance Act. However, there are various differences between the Model Law and the Recognition and Assistance Act. The four major ones are explained as follows.

Firstly, the Model Law does not apply to entities, mainly financial institutions, whose insolvency procedures are subject to special regulations by the State.[187] Additionally, its legislative guide describes the options for consumer bankruptcy exemptions, which means that the State may choose not to apply the law to consumers. On the other hand, in Japan, the Recognition and Assistance Act does not make such stipulations for entities that are subject to special regulations as the Model Law does, which means that the Recognition and Assistance Act applies to financial institutions as well. Further, the Recognition and Assistance Act does not exclude consumers from the scope of recognition assistance.[188]

Secondly, the Recognition and Assistance Act does not provide for any co-operation or direct communication between domestic and foreign courts as stipulated in article 25, paragraphs 1 and 2 of the Model Law. On the other hand, it does clarify the co-operation between trustees in Japan and foreign countries.

Thirdly, article 3 of the Model Law prioritises the international obligations of the State, while the Recognition and Assistance Act has no such provisions. This is a matter of course in Japan due

[187] Recognition and Assistance Act, art 1, para 2.

[188] In practice, art 17 of the Recognition and Assistance Act recognises one's domicile or residence as a requirement for petitioning the court for recognition, which means that consumers are clearly included.

to the priority of treaties and laws under the Constitution, and because there is no existing bilateral treaty on international insolvency in this country.

Fourthly, regarding public policy, article 6 of the Model Law provides a public policy exception and refuses any action that would be manifestly contrary to the public policy of the State. However, the Recognition and Assistance Act does not adopt the "manifestly" part of the language of the Model Law for its public policy requirement,[189] while some other requirements do include it,[190] which means that this language was intentionally not used in the public policy. Regardless, the public policy is unclear, and thus subject to the court's decision.

7.3 Overview of the recognition proceedings

7.3.1 Requirements for recognition

In Japan, foreign insolvency proceedings are recognised by a decision of a domestic court. The first requirement for recognition is the international insolvency jurisdiction.[191] Recognition is given to both foreign main and non-main proceedings. However, the jurisdiction over merely the location of property is not recognised. Accordance with public policy is also a requirement for recognition, which refuses procedures that discriminate against foreign creditors or are contrary to Japanese insolvency law and policy. In addition, other grounds for denial of recognition include (1) failure to prepay expenses, (2) foreign proceedings manifestly subject to territoriality, (3) when recognition is manifestly unnecessary, (4) when a foreign trustee violates the obligation to report (except minor violations), and (5) bad faith in filing a petition.[192]

7.3.2 Procedures for recognition

Although the Tokyo District Court has exclusive jurisdiction over recognition cases, those cases can be transferred after the recognition is ordered.[193]

The right to petition for recognition belongs exclusively to the foreign trustee, or the debtor if there is no foreign trustee.[194]

After filing a petition for recognition, the foreign trustee is obligated to report to the court the progress of the foreign proceedings and other matters ordered by the same.[195] In addition, the court may order the foreign trustee to appoint an attorney-at-law to act as its agent to facilitate communication.[196]

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[189] Recognition and Assistance Act, art 21, item 3.
[190] *Idem*, art 21, items 2, 4 and 6.
[191] *Idem*, art 17, para 1.
[192] *Idem*, art 21.
[193] *Idem*, arts 4 and 5.
[194] *Idem*, art 17, para 1.
[195] *Idem*, art 17, para 3.
[196] *Idem*, art 17, para 4.

Upon a filing for recognition, an order to stay other proceedings and the exercise of security interests, and/or an order to preserve the assets may be issued prior to the order of recognition being issued.[197] Particularly, in cases where foreign proceedings have not yet commenced, it is not possible to immediately issue an order of recognition, so these temporary restraining orders are useful.

When an order of recognition is finally issued, a public notice is made. In principle, creditors are not individually notified, but tax authorities and labour unions are notified.[198]

7.3.3 Effect of approval

Based on the issued recognition, the court can order the stay of other proceedings, including orders to suspend any execution, provisional seizure and/or lawsuit related to property in Japan. In addition, it can order a comprehensive stay of execution for all creditors, or issue a stay order for the exercise of security interests if special requirements are met. Furthermore, the court may prohibit the repayment and disposition of the debtor's business or property in order to preserve that property.[199]

The court may order a foreign trustee to manage the business and property of the debtor in Japan. The right to manage and dispose of the domestic property and the right to conduct business shall be vested exclusively in the appointed person.[200]

7.3.4 Multiple insolvency proceedings

In Japan, the Recognition and Assistance Act adopts the idea that only one procedure is in effect even if the debtor is involved in multiple proceedings.

Firstly, domestic insolvency proceedings basically have priority over foreign ones. If the domestic proceedings have already commenced, the petition for recognition of the foreign proceedings will be dismissed. If the domestic proceedings commence after the recognition, then the recognition proceedings will be suspended. However, there are exceptional cases where the recognition procedure takes precedence over the domestic procedure. Specifically, this happens when the foreign proceedings are the main proceedings and the interests of domestic creditors are not unreasonably infringed by the recognition of those proceedings, which are in accordance with the general interests of creditors. In such cases, the domestic procedure is stayed due to the recognition of the foreign procedure. The discontinued domestic procedure shall expire if the recognition procedure is cancelled due to the completion of the foreign procedure, or shall continue if it is cancelled for any other reason.[201]

Secondly, foreign main procedures have priority over foreign non-main ones. Therefore, a petition for recognition of a foreign non-main procedure is dismissed after recognition of the

[197] *Idem*, art 25, para 2.
[198] *Idem*, art 23, para 1.
[199] *Idem*, art 25 to 28.
[200] *Idem*, arts 32 and 34.
[201] *Idem*, arts 57 to 58 and 61.

foreign main procedure. When recognition of the foreign main proceedings is granted after recognition of the foreign non-main proceedings, the latter are stayed. On the other hand, there is no principle of priority between the non-main proceedings. If the recognition of a subsequently filed foreign non-main procedure is found to be more suitable to the general interests of creditors, it shall be recognised and the prior recognition procedure shall be stayed. The discontinued recognition procedure shall expire if the ongoing one is cancelled due to the completion of the foreign procedure, or shall continue if it is cancelled for any other reason.[202]

7.4 Overview of the recognition proceedings

The first full-scale cross-border insolvency case in Japan was the Azabu Building case in 2006. The debtor had actively invested in overseas real estate and resorts in the 1990s, but after its financial state deteriorated, most of its domestic assets were disposed of, leaving only a hotel property in Hawaii. A Chapter 11 proceeding under the US Bankruptcy Code was then filed in the Hawaii court. However, since there were residual assets such as cash in Japan, a recognition of the Chapter 11 proceeding was filed to prevent the execution of security interests in Japan. This was the second recognition case of overseas insolvency proceedings, and the first in which a Chapter 11 proceeding was recognised in Japan.

In 2008, there was a concern as to whether a Chapter 11 restructuring plan would be effective in Japan. Therefore, the recognition proceeding was withdrawn and a corporate reorganisation proceeding was filed in Japan, resulting in two pending insolvency proceedings of the same debtor in parallel. In the Japanese reorganisation proceeding, a reorganisation plan that was basically identical to the one in the US Chapter 11 proceeding was developed and approved. Thus, the first full-scale cross-border insolvency case in Japan was successfully and smoothly handled, demonstrating that the new international bankruptcy law system is fully functional in practice.

Self-Assessment Exercise 6

Describe how to deal with multiple insolvency proceedings of the same debtor.

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

A final and binding judgment by a foreign court (foreign judgment) can be recognised in Japan and shall be effective automatically without any particular proceedings (automatic recognition) when the foreign judgment meets the following requirements:[203]

[202] *Idem*, arts 62 to 64.
[203] Code of Civil Procedure, art 118, items 1 to 4.

(i) the jurisdiction of the foreign court is recognised pursuant to applicable laws, regulations, conventions or treaties;

(ii) the defeated defendant was served (excluding service by publication or any other service similar thereto) with the requisite summons or order for the commencement of litigation, or appeared without being so served;

(iii) the judgment and the litigation proceedings are not contrary to public policy in Japan; and

(iv) a guarantee of reciprocity is in place.

Criterion (i) means that the country where the foreign court is located (the adjudicating country) has international jurisdiction over the case under the principles of the international civil procedure law of Japan, which is a recognising country. This international jurisdiction is called "indirect jurisdiction".[204] With regard to the standard to determine whether the foreign court has indirect jurisdiction, the Supreme Court of Japan held that it is appropriate for Japan to recognise a foreign court judgment in accordance with the principle of law by taking into consideration the specific circumstances of each case, while basically conforming to the provisions related to international jurisdiction stipulated in the Code of Civil Procedure.[205]

As for the third requirement of public policy in criterion (iii), the Supreme Court held that a foreign judgment ordering punitive damages has no effect because it is contrary to the public policy in Japan.[206] In addition, the Supreme Court held that the proceedings of the foreign judgment are considered to be incompatible with the fundamental principles of the Japanese legal order, and are therefore against public policy, if it becomes final and binding without the parties being given an opportunity to appeal because they were not informed of it or were not given an opportunity to be informed.[207]

With regard to the reciprocity requirement in criterion (iv), the recognition is limited to cases where a Japanese court judgment in a similar case can be guaranteed to be recognised and enforced in the foreign country in question. This is determined based on whether the conditions for recognition in the foreign country do not differ in material respects from those in Japan.[208] In the precedents, reciprocity was found in the United States (namely, California, New York, Hawaii and Nevada), Germany, England, Singapore and Hong Kong, while the enforcement of judgments in Belgium and the People's Republic of China were denied.

To enforce a foreign judgment, a judgment of execution must be obtained.[209] In an action seeking an execution judgment, the court examines whether the foreign judgment meets the

[204] Conversely, the international jurisdiction necessary to render a judgment on the merits of an action filed in a Japanese court is referred to as "direct jurisdiction".
[205] Supreme Court, April 24, 2014, Supreme Court Civil Casebook (*Minshu*), Vol 68, No 4, p 329.
[206] Supreme Court, July 11, 1997, Supreme Court Civil Casebook (*Minshu*), Vol 51, No 6, p 2573.
[207] Supreme Court, January 18, 1991, Supreme Court Civil Casebook (*Minshu*), Vol 73, No 1, p 1.
[208] Supreme Court, June 7, 1983, Supreme Court Civil Casebook (*Minshu*), Vol 37, No 5, p 611.
[209] Civil Execution Act (Act No 4 of 1979), art 22, item 6.

four criteria for recognition mentioned above. If the court acknowledges that the criteria have been met, it will allow the enforcement based on the foreign judgment.[210]

Self-Assessment Exercise 7

Indicate whether Japanese courts will recognise and enforce the following foreign judgments:

Question 1

Judgments rendered without any attendance because the complaints were served by post.

Question 2

Judgments ordering punitive damages.

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

9. INSOLVENCY LAW REFORM

There are three major upcoming insolvency law reforms under consideration by the Japanese government (see paragraphs 9.1 and 9.2), or that have already passed as the relevant bill (see paragraph 9.3), waiting to take effect.

9.1 Majority voting system in a new hybrid workout

As mentioned in paragraph 6.5.4.1, even though rule-based out-of-court workouts are common restructuring tools nowadays in Japan, they require the unanimous approval of all participating creditors in order to make a restructuring plan binding. In 2022, the Japanese government revealed that it is considering the adoption of new out-of-court workout legislation. Under the new regulations, a restructuring plan will be legally binding if it receives a majority of the creditors' approval and court confirmation. This hybrid workout is supposed to be similar to some extent to the Scheme of Arrangement in the UK, StaRUG in Germany and WHOA in the Netherlands.

In the most recent significant case in 2022, Marelli Holdings Co., Ltd. attempted restructuring through Turnaround ADR. Its restructuring plan was ultimately rejected by 5% of the participant creditors, forcing the debtor to enter a judicial rehabilitation proceeding. Afterwards, the restructuring was completed swiftly by "cramming down" the minority lenders through a simplified rehabilitation process, which is explained in paragraph 6.5.2.15. However, this delayed the restructuring slightly, damaged the reputation of the debtor, and caused considerable difficulty in getting the creditors to understand the transition from the workout to

[210] *Idem*, art 24, para 4.

the in-court process. Accordingly, majority voting in out-of-court restructuring is now being taken into account in the upcoming legislation, following a protracted discussion amongst academics and practitioners.

The new legislation must clear some of the concerns arising from a majority vote. For instance, dissenting creditors should be well-protected under the regulations in the view of property rights. The voting process must also be structured equitably and consistently. Amongst other things, there should be a good balance between the need for quick corporate restructuring and the fairness of the new process. The new law will specify the relevant guidelines, but one solution is to call for the court's confirmation of the restructuring plan in order to secure fairness.

9.2 Reform of secured transactions law

The Japanese government published the Interim Proposal on the Reform of Secured Transaction Law on 20 January 2023, with the aim of regulating security interests in secured transactions, including security assignments and sales with retention of title. As explained in paragraph 5.2.2, these transactions are commonly used to secure financing but have relied on court precedents, resulting in ambiguity. The proposal seeks to introduce clear rules, allowing multiple security interests over a single asset through multiple security assignments and providing definitions for aggregation of movables and claims. The background is that, historically in Japan, bank lending has predominantly been supported by real estate collateral and personal guarantees, limiting the financing options for small and medium-sized enterprises and start-ups. To diversify financing, the proposal allows for the use of movable property and receivables as collateral, providing clarity on security assignment rules, order of priority amongst competing security interests, their enforcement, and their treatment in insolvency proceedings.

Additionally, the proposal explores the concept of an all-assets security interest called "Business Growth Security Interest", on which another report was also published on 10 February 2023. This innovative approach aims to secure financing for businesses without tangible assets, such as start-ups, by leveraging the potential value of the entire business. The potential policy could additionally streamline financing during the restructuring phase, including the possibility of utilising DIP financing. This may enable a greater number of debtor companies to steer clear of bankruptcy by capitalising based on this approach.

The proposal leaves several issues to be discussed, including amendments to the registration system, handling of movables and claims in insolvency proceedings, clawback provisions, and the specifics of Business Growth Security Interest. Overall, it represents a significant reform in Japanese secured transactions law, potentially making financing more diverse, secure and predictable.

9.3 Digitisation of in-court insolvency proceedings

On 6 June 2023, the Act on the Development of Related Laws to Promote the Utilisation of Information and Communication Technology in Civil-Related Procedures was enacted with provisions for the full-scale digitisation of civil-related procedures, including insolvency

proceedings. The implementation of digitisation in civil lawsuit proceedings has already been initiated. This law will be enforced within five years after 14 June 2023.

With regard to insolvency proceedings, it will be mandatory to file petitions online in bankruptcy proceedings where a trustee is appointed, and the court claim investigations and the creditors' meetings may be held via web conference.

10. USEFUL INFORMATION

English translations of the relevant laws can be read in the links below.

- Civil Code
  https://www.japaneselawtranslation.go.jp/ja/laws/view/4314
- Bankruptcy Act
  https://www.japaneselawtranslation.go.jp/ja/laws/view/3780/je#je_ch1at2
- Companies Act
  https://www.japaneselawtranslation.go.jp/ja/laws/view/3206
- Civil Rehabilitation Act
  https://www.japaneselawtranslation.go.jp/ja/laws/view/4425
- Corporate Reorganisation Act
  https://www.japaneselawtranslation.go.jp/en/laws/view/4422
- Act on Special Conciliation for Expediting Arrangement of Specified Debts
  https://www.japaneselawtranslation.go.jp/ja/laws/view/2722
- Act on Recognition of and Assistance for Foreign Insolvency Proceedings
  https://www.japaneselawtranslation.go.jp/en/laws/view/3780

APPENDIX A: FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Describe the special treatment of cases with a number of creditors.

Commentary and Feedback on Self-Assessment Exercise 1

In situations where there are 500 or more creditors involved, a petition can be filed with the district court where the original jurisdictional court of appeal (high court) is situated. If the case involves 1,000 or more creditors, a petition can alternatively be filed with either the Tokyo or Osaka District Court. Given the potential intricacies of managing extensive cases, these larger courts with specialised divisions are authorised to handle such matters. Notably, both district courts maintain dedicated divisions specifically designated for the handling of insolvency cases.

Self-Assessment Exercise 2

Under Japanese law, what options are there for security interests over tangible movables? Outline the possible measures.

Commentary and Feedback on Self-Assessment Exercise 2

If the debtor does not provide the creditor with any real estate for security interests, or the amount to be secured is not large, tangible movables such as inventory or machines are possible collateral. There are several options for collateral of tangible movables to secure the payment:

Firstly, a pledge can be agreed for the security interests. However, the subject collateral must be held by the creditor for the pledge to be effective. Therefore, if the collateral does not need to be at the owner's location, this can be an option.

Secondly, there are security interests by way of assignment. The debtor or the guarantor transfers its rights to the creditor to secure the claim and agrees to return those rights once the claim has been paid. This option is workable if the owner has to keep and use the movables at its own location.

Thirdly, retention of title can be considered if the creditor would like to secure the repayment in a sales contract and retain the ownership of the sales subject. This allows the debtor to keep and use the property at its location. To use this option, the retention of title must be stated in the sales agreement.

Fourthly, a statutory lien is placed automatically over the movable property if the case falls under any of the situations described in the statutes, such as if the claim arises from the property (for example, sales proceeds). This option can be exercised even if the property is in the debtor's possession.

Lastly, if the creditor has a claim arising from the property and has possession, it may also refuse to return it, as the right of retention, until the payment is made.

Self-Assessment Exercise 3

Question 1

What distinct aspects do personal insolvency proceedings have compared to corporate insolvency proceedings?

Question 2

How can one select a proceeding for consumer insolvency among possible measures?

Commentary and Feedback Self-Assessment Exercise 3

Question 1

Consumer bankruptcy differs significantly from corporate bankruptcy in that, unlike corporations, most consumer debtors receive a discharge and do not cease to exist after the proceedings. The discharge process serves as a method for the economic recovery of debtors. Furthermore, in most instances, consumers possess fewer assets to contribute to an estate. In bankruptcy proceedings, if the insolvent does not have sufficient assets to cover the procedural expenses, which is common, the bankruptcy procedure is discontinued as is the appointment of a trustee. There will be no further bankruptcy proceedings, and a separate hearing will be held on the discharge procedure.

Question 2

In Japan, there are several options for consumers to select from to address their insolvency, relying on the extent of their ability to repay. In general, the debtor selects out-of-court negotiation or special conciliation if they can repay the entire principal with three to five years of income, individual rehabilitation if it is difficult to repay the entire principal but a substantial amount can be repaid, or, if even that is difficult, bankruptcy to be discharged.

Self-Assessment Exercise 4

Describe the priority among the claims related to bankruptcy proceedings.

Commentary and Feedback on Self-Assessment Exercise 4

In bankruptcy proceedings, there are two categories of claims: bankruptcy claims and claims on the estate. Separately, secured claims are repaid outside the proceedings.

On the one hand, priority repayment is guaranteed for claims on the estate over bankruptcy claims. A typical claim on the estate is a claim for expenses necessary for the bankruptcy proceedings that arise after the proceedings commence, and tax and wage claims are also considered as claims on the estate. Claims on the estate may be paid when performance is due outside bankruptcy proceedings. However, if the estate does not have sufficient assets and the full amount of the claims on the estate cannot be repaid, the claims on the estate are basically repaid proportionately to the available assets.

On the other hand, bankruptcy claims are claims on property against the insolvent that arose from causes prior to the commencement of bankruptcy proceedings. Among bankruptcy claims, claims with statutory liens are entitled to distribution as preferred bankruptcy claims and have priority over other bankruptcy claims. The order of priority amongst preferred bankruptcy claims is governed by substantive law. In the end, other bankruptcy claims are repaid in the distribution.

Self-Assessment Exercise 5

What are the advantages and disadvantages of the Japanese rule-based out-of-court insolvency proceedings?

Commentary and Feedback on Self-Assessment Exercise 5

The advantages of rule-based out-of-court workouts compared to court proceedings can be summarised as follows:

1. Preservation of Going-Concern Value: They enable debtors to discreetly maintain their going-concern value, protecting their assets from harmful rumours and disruptions that can occur in public court proceedings. This discretion benefits both the debtor and financial creditors.

2. Simplicity and Flexibility: Private workouts are simpler and more flexible, relying on unanimous creditor approval and avoiding the need for judges or trustees. This simplicity contrasts with the complexity of court proceedings.

3. Transparency and Predictability: While court proceedings adhere to legal provisions for transparency, private workouts benefit from guidelines and rules that provide structure and predictability, enhancing clarity in the process.

4. Fairness and Neutrality: Private workouts can involve neutral experts' review, promoting objectivity compared to workouts managed solely by the debtor and concerned creditors.

5. Faster Resolution: They often lead to quicker resolutions, allowing debtors to restart their business sooner compared to potentially lengthy court proceedings.

6. Lower Costs: Private workouts are generally less expensive, avoiding court-related expenses and higher attorney's fees associated with court proceedings.

7. Tax Benefits for Creditors: Creditors participating in private workouts can deduct waived claims as expenses for tax purposes, similar to court proceedings.

8. Management Protection: Guidelines in Japan offer protection for management, such as directors, against personal liability for guarantees, particularly accessible in private workouts, encouraging faster restructuring decisions.

9. Grace Period for Delisting: Listed enterprises benefit from Turnaround ADR that does not trigger delisting, providing them with an extended grace period for delisting if insolvency is expected to be resolved through Turnaround ADR.

On the other hand, out-of-court workouts have two key disadvantages:

1. Unanimous Approval Requirement: These workouts demand unanimous consent from all creditors to enforce the restructuring plan. Achieving this consensus can be more challenging compared to court proceedings, where plans can be approved through voting.

2. No Standstill for Trade Creditors: Private workouts lack a standstill period for trade creditors. While financial creditors may agree to postpone the collection of loan principal, trade creditors, who typically do not participate in the workout, may insist on immediate repayment. If a debtor faces urgent difficulties in meeting its commercial creditors' demands, it may not survive until the workout's completion and may need to initiate court proceedings to halt repayments to creditors.

Self-Assessment Exercise 6

Describe how to deal with multiple insolvency proceedings of the same debtor.

Commentary and Feedback on Self-Assessment Exercise 6

In Japan, the Recognition and Assistance Act adopts the idea that only one procedure is in effect even if the debtor is involved in multiple proceedings.

In insolvency cases, domestic proceedings generally take precedence over foreign ones. If domestic proceedings have started, any request to recognise foreign proceedings will be rejected. If domestic proceedings begin after recognition of foreign proceedings, the recognition process is paused. However, there are exceptions when foreign proceedings are considered primary, and domestic creditors' interests are not unreasonably harmed by recognising them. In such cases, domestic proceedings are suspended due to the recognition of foreign proceedings. If the foreign procedure is completed, the domestic proceedings that were paused may either end or continue, depending on the reason for cancelling recognition.

Main insolvency procedures are prioritised over non-main ones. Consequently, a request to recognise a non-main foreign procedure is dismissed once the main foreign procedure has been recognised. If recognition of the main foreign proceedings comes after the recognition of non-main foreign proceedings, the latter are temporarily suspended. However, there is no inherent priority among non-main proceedings. If a subsequently filed non-main foreign procedure better serves the general interests of creditors, it will be recognised, and the prior recognition process will be put on hold. The paused recognition process will either conclude if the ongoing process is cancelled upon the completion of the foreign proceedings or will continue if cancelled for any other reason.

Self-Assessment Exercise 7

Indicate whether Japanese courts will recognise and enforce the following foreign judgments:

Question 1

Judgments rendered without any attendance because the complaints were served by post.

Question 2

Judgments ordering punitive damages.

Commentary and Feedback on Self-Assessment Exercise 7

Question 1

According to article 118, item 2 of the Code of Civil Procedure, the foreign judgment cannot be recognised if the defeated defendant was served, excluding service by publication or any other service similar thereto, with the requisite summons or order for the commencement of litigation, or appeared without being so served. In this case, the defendant did not attend the court hearing and was defeated as a result, but (s)he was served by post, not in a publication, and thus had a chance to be aware of the lawsuit. Consequently, the Code of Civil Procedure does not apply, so the foreign judgment can be recognised and enforced in Japan.

Question 2

The public policy is at issue. According to article 118, item 3 of the Code of Civil Procedure, for foreign judgments to be recognised in Japan, the judgment and the litigation proceedings in the foreign country must not be contrary to public policy in Japan. In the case law, the system of punitive damages is deemed as contrary to public policy in Japan. Therefore, Japanese courts may not recognise or enforce foreign judgments ordering punitive damages.

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