

Revised Japanese Corporate Reorganization Law

Submitted to: IPBA 2003, Insolvency Committee
(February 19)

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1. Introduction

In Japan, there are three types of statutory reorganization mechanisms¹: corporate reorganization (*kaisha kosei*), civil rehabilitation (*minji saisei*) and corporate arrangement (*kaisha seiri*)². Among these three, corporate reorganization is the most pro-debtor system. Corporate arrangement³ is, in short, debt restructuring with the consent of all creditors⁴ under the court's supervision. Civil rehabilitation, introduced in 2000, is now very popular mostly because it is quick⁵ and it allows pre-filing management to keep its office in normal cases. Civil rehabilitation plan, however, binds only unsecured, non-priority claim holders (creditors). Creditors holding priority claims such as tax and retirement allowance are free to exercise their rights. Secured creditors can foreclose its collateral with some exceptions, and in most cases they can be bound only by an agreement that provides for terms not less attractive than foreclosure⁶. This experience pushed forward the movement to revise the Corporate Reorganization Law, and the revised bill passed the Diet in December 2002⁷.

2. New Features of the Revised Corporate Reorganization Law

The revised Corporate Reorganization Law (the "Revised Law") aims to increase swiftness and flexibility in corporate reorganization cases. Below are major new features of the Revised Law:

¹ There are two statutory liquidation mechanisms – bankruptcy and special liquidation.

² For financial institutions, "Law on Special Treatment in Financial Institution's Corporate Reorganization and Other Procedure" is also applicable.

³ Commercial Code, Arts. 381 – 403.

⁴ In practice, when more than 90% of the creditors consent to the arrangement plan and the court considers that plan can be executed even with minor dissenting creditors, the court orders to implement the plan.

⁵ In most cases, it takes about 6-7 months from filing to plan approval /disapproval.

⁶ Debtor may ask the court for temporary injunction of foreclosure if the debtor succeeds in showing that the injunction will serve the general benefit of the creditors and that the injunction is not likely to cause undue damage to the foreclosing party. Debtor may also ask the court to determine the value of the collateral and pay off the secured claim. With these powers, debtor often seeks to enter into individual agreement with secured creditors that typically provides install repayment of secured claims. For handy introduction of the Civil Rehabilitation Law, see "The New Japanese Reorganization Procedures" (Masafumi Kodama, ABI Journal, October 2001 and http://www.kitahama.or.jp/Japanese/library/pdf/abi2001_10_18.PDF)

⁷ The revised law is said to become in force in April 2003.

(1) In order to manage the case more quickly, the Revised Law introduced two kinds of frame. One is that reorganization plan must be submitted within one year after the commencement order unless such term is extended by the court under special circumstances⁸. There used to be no such limitation, and in voluminous cases it sometimes took years before the plan was filed. The other reform is to provide that the repayment under the plan must be completed within 15 years, as opposed to 20 years under the current law⁹.

(2) The Revised Law loosened the criteria to issue a commencement order. Formerly, petition for commencement is dismissed, among others, when the court finds that there is no prospect for the debtor's reorganization. In order to verify this point, the court requested investigation of debtor's business in detail, and it took at least a month and in some cases more than a year from the filing of petition to the commencement order. The Revised Law provides that the petition is dismissed, among others, when it is clear to the court that there is no prospect for submission and/or approval of a plan which provides for continuance of business¹⁰. This amendment substantially removes the court's burden to make managerial judgement, and is expected to shorten the time for the court to issue an commencement order.

(3) Other than timing issue, one of the most important amendments is that the Revised Law has come to allow DIP (debtor-in-possession) with some limitations. In corporate reorganization cases, all powers and authorities of directors are suspended upon filing the case and the company is managed by court-appointed interim trustee(s) (from filing to commencement order) and trustee(s) (after the commencement order). Formerly, the court appointed interim trustees and trustees only from outside the company (typically lawyers and business people). The Revised Law allows the court to appoint pre-filing director as an interim trustee and a trustee, so long as he/she is not liable to the company for breach of fiduciary duty and other duties¹¹.

(4) Transfer of debtor's business before submission of the plan has become explicitly possible with the court approval¹².

⁸ The Revised Law, Art. 184, Sections 3 and 4.

⁹ The Revised Law, Art. 168, Sec. 5. This term is 10 years in civil rehabilitation.

¹⁰ The Revised Law, Art. 41, Sec. 1

¹¹ The Revised Law, Art. 30, Sec. 2 and Art. 67, Sec. 3.

¹² The Revised Law, Art. 46.

(5) Security interest on debtor's assets can be cancelled¹³. Trustee may pay to the court the amount equal to the value of the collateral asset and request the court to cancel security interest on the collateral. The court holds the money for future distribution to the secured creditors until the approval of the plan, but may return to the trustee the amount that exceeds the aggregate amount of all secured claims on the collateral. This can be utilized, for instance, when the trustee wants to sell the debtor's business before submitting the plan, or when the trustee wants to sell the debtor's specific asset in order to escape from heavy property tax. On the other hand, a secured creditor can foreclose the collateral when such collateral is clearly not necessary to restructure the debtor's business¹⁴.

(6) The plan passes the Interested Parties' Meeting by smaller affirmative vote. The number of necessary affirmative votes was reduced from 2/3 to 1/2 of the total amount of the claims as to unsecured creditors, from 3/4 to 2/3 as to secured creditors who are requested to postpone repayment date, and from 4/5 to 3/4 as to secured creditors who are requested to waive a part of secured claims¹⁵¹⁶.

3. Brief Outline of Corporate Reorganization under the Revised Law

For comprehensive understanding of the impact of the revision, I will try to briefly describe the overall structure of corporate reorganization by explaining the roles, rights and duties of the relevant parties.

(1) Debtor

Only joint stock company (*kabushiki kaisha*) is eligible to file the corporate reorganization petition.

(2) Court

The Court exercises strong supervisory power by appointing (interim) trustee and require court approval on most of the important actions by (interim) trustee.

¹³ The Revised Law, Arts. 104 – 112.

¹⁴ The Revised Law, Art. 50, Sec. 7

¹⁵ The Revised Law, Art. 196, Sec. 5

¹⁶ Note that the taxing authority's consent is necessary when the plan provides for extension of tax payment for more than 3 years. The Revised Law, Art. 196 (this part is unchanged).

(3) Directors

All powers and authorities of directors are suspended while corporate reorganization is pending.

(4) Interim Trustee

The court appoints interim trustee(s) after filing (and until the court determines whether the commencement order can be issued) (see 2.(3) above). The interim trustee is in charge of managing the debtor company during this interim period. Usually lawyer(s) are appointed as interim trustee(s).

(5) Trustee

The court appoints trustee(s) upon issuing commencement order. The trustee is primarily responsible for all matters relating to the debtor under the court's supervision: the trustee manages the company, investigates assets of the debtor (including evaluation of collateral and exercise of avoidance power), investigates liabilities of the debtor (including examination of proof of claims), disposing debtor's assets when necessary (this includes transfer of business which may be accompanied by the request to cancel security interests), submission of reorganization plan and implementation of the plan after approval. In many cases, a business person who is supposed to be the future president of the debtor after reorganization is appointed as a trustee along with a lawyer.

(6) Creditors

There are common interest creditors, secured creditors, unsecured creditors, post-commencement creditors and tax creditors. Common interest claims include (i) costs and liabilities for management of the debtor's business and corporate reorganization case after commencement, (ii) 1/3 of employee's retirement allowance, and (iii) employee's unpaid salary in recent 6 months. Common interest claims must be paid when due (outside the plan)¹⁷. Other creditors are, upon issuance of commencement order, automatically forbidden to collect the debt or enforce its rights by attachment and /or foreclosure. For tax creditors, however, the stay period is one year unless the creditor agrees to the extension¹⁸. Setoff is allowed with some limitations¹⁹. During the interim period (between filing and commencement order), the court may issue individual or comprehensive injunction of attachment and foreclosure process (meaning that filing

¹⁷ The Revised Law, Arts. 127-133.

¹⁸ The Revised Law, Art. 50.

¹⁹ The Revised Law, Art. 48.

does not trigger automatic stay)²⁰.

Creditors may form one or more creditors' committees. When the court approves creditors' committee to get involved in the case, the trustee must report some matters to the committee²¹.

(7) Shareholders

Shareholders have no voting rights in corporate reorganization when the debtor is insolvent²².

4. Conclusion

Corporate Reorganization Law is said to be most suitable for large companies, because it binds secured creditors and tax creditors, and the plan itself may provide for change of articles of incorporation, redemption and issuance of stocks, merger and other important corporate actions. It is quite timely that the law is revised to increase swiftness and flexibility when the Japanese economy is still unable to find its way out from the long recession.

²⁰ The Revised Law, Arts. 24 and 25.

²¹ The Revised Law, Arts. 117-121. Information that must be provided to the committee is some of the reports that the trustee must submit to the court.

²² The Revised Law, Art. 166.