

**RESPONSE TO SUBJECT OUTLINE FOR
INTERNATIONAL BAR ASSOCIATION/AMERICAN BANKRUPTCY INSTITUTE
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Report for Japan
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1. Reorganization Law

1.1 Principal Laws Governing Reorganization

1.1.1 Laws Which Apply To Formal Or Judicial Reorganization

Reorganization under the Corporate Reorganization Act ("Corporate Reorganization") or under the Commercial Code ("Corporate Arrangement") applies only to a kabushiki kaisha (a stock company). Reorganization under the Composition Act ("Composition") applies to all debtors, individual or corporate, including a kabushiki kaisha.

Corporate Reorganization is processed by a trustee under the supervision of the court. The trustee deals with both secured and unsecured creditors whose rights are stayed and changed, until and as provided for in a plan, covering both secured and unsecured claims, submitted for the creditors' consent in legal majorities.

Corporate Arrangement is a type of reorganization in which the management remains and conducts business under the supervision of the court. Secured creditors' rights may be stayed if necessary, but not as a matter of course. A plan of reorganization under Corporate Arrangement must cover unsecured creditors, and may cover secured creditors if needed.

Composition is another debtor in management type of proceeding under the court's supervision. The secured creditor is not stayed from enforcing its rights. A plan dealing with only unsecured creditors is to be agreed upon by the requisite majority of unsecured creditors followed by confirmation of the court.

1.2 Courts Which Administer Reorganization

1.2.1 Courts Which May Be Involved In A Reorganization

The District Court, courts of general and original jurisdiction, will exercise jurisdiction over all reorganization. The District Court, having jurisdiction (or venue) over the location of the corporate debtor's registered or main office, or the individual's residence, has in all reorganization exclusive jurisdiction. In the case of a foreign business, the location of its local main office will provide the basis for the reorganization jurisdiction, while as for a Composition, the location of assets will also be sufficient for the jurisdiction.

1.3 Jurisdiction Of Courts Over:

1.3.1 Debtor, Its Officers, And Directors

Courts will exercise jurisdiction over the debtor with respect to all matters under the reorganization laws, and most of the matters relating to the reorganization. For example, matters relating to claims determination may be continued in other courts, after a stay in a Corporate Reorganization, and at any time in a Corporate Arrangement or Composition. Also, matters relating to property of the estate to be initiated by the estate are subject to general jurisdictional principles. In a Corporate Reorganization or Corporate Arrangement, directors and officers are made subject to summary jurisdiction of the courts having jurisdiction over the debtor for their director/officer liability issues.

1.3.2 Assets (Turnover Of Property And Collection Of Claims)

Courts sitting in reorganization have jurisdiction over assets of the debtor. Upon court's order to commence a reorganization proceeding, the court is required to notice all parties in possession of property of the estate or owing a debt to the estate to turnover the property or to pay the debt. A big issue lies here as to whether the court's jurisdiction extends over assets situated outside of the jurisdiction. The reorganization acts are in uniformity in providing literally that Japanese reorganization proceedings do not extend to assets located abroad. Without having revised the acts, this is not so any more in reality of the Japanese reorganization. The reorganization proceeding and the court's jurisdiction extend to assets situated outside of the country, and thus turnover and payment is made to the court or its representative. This is made possible and explained by decisional law

development supported by academics and the prevalent course of practice or conduct.

1.3.3 Secured Creditor

To be precise, no theoretical effort of distinguishing personal jurisdiction from *in rem* jurisdiction over a secured creditor is evident. Instead, jurisdiction is comprised of a set of itemized jurisdictional concepts, including general matter jurisdiction, tort liability jurisdiction, place of performance jurisdiction, location of property, and so forth. If a secured creditor is by one of these criteria is subject to the jurisdiction of the Japanese Court, then it is made subject to the court's jurisdiction sitting in reorganization. Again, however, here arises the issue of whether or not the jurisdiction of the court extends over collateralized assets abroad. Here, the recognized basis for turnover jurisdiction is susceptible to some qualification. A majority view is that a secured creditor in an interest in foreign situated property may proceed outside of the reorganization. A little caveat: a domestic secured creditor who is secured by a foreign situated property may not be as free as a purely foreign counterpart since it may be required to disgorge what it has realized abroad; and a foreign secured creditor who has filed its claim may lose its rights over the assets of the reorganization proceeding. A better view may be that a secured creditor secured by a foreign situated property will be made subject to some kind of procedural restraint, whether it be under the main proceeding which has been opened in Japan, or a proceeding in the foreign country ancillary to or independent of the main proceeding that is opened by the representative of the main proceeding.

1.3.4 Unsecured Creditor

The same principles shown above as applicable to a secured creditor are likewise applicable to the status of the unsecured creditor, except that the foreign property issue is placed in a different aspect, namely, whether or not an unsecured creditor may sue in the foreign country and enforce its rights on judgment or attachment against the foreign situated property. The majority view and the better view introduced above will also be made applicable with needed qualifications.

1.3.5 Holder Of Equity Interests

It is without much doubt that holders of equity interests are subject to the jurisdiction of the Court sitting in reorganization. This conclusion is regardless of whether the holder is located out of the reorganization jurisdiction.

1.3.6 Matters Related To The Debtor, Its Assets Or Its Relations With Creditors

As discussed above in 1.3.4 and 1.3.5 above, assumption or rejection of executory contracts, priority among claims, disposition of assets, avoidance of preferences, and distribution or plan implementation are subject to the court's jurisdiction. If such foreign elements as discussed above in 1.3.3 and 1.3.4 are involved, the court's jurisdiction over these matters considered here become unclear. A majority view is that the court will principally apply both procedural and substantive laws of the bankruptcy forum, subject to private international law principles as appropriate.

1.4 Venue

Matters to be considered under venue have been discussed in 1.2 above.

2. Commencement of A Reorganization

2.1 Requirement For Debtor To Commence A Case

2.1.1 Corporate Authority

Every kabushiki kaisha is eligible for Corporate Reorganization and Corporate Arrangement. All corporations are eligible for Composition. Corporate authority for commencing a case under Corporate Reorganization lies with a board of directors resolving in favor by its majority vote. Corporate Arrangement is opened by a director petitioning the court. Composition is commenced only by an unanimous vote in favor by the board of directors. In reorganization, filing of a petition does not commence the case petitioned. A case is commenced only upon the adjudication by the court having considered the application documents. During the time period after the filing of a petition and before adjudication, the court will on its own motion or application, order a preservation order, including an order appointing an interim trustee in Corporate Reorganization or Corporate

Arrangement. The sphere of power and responsibility of such an interim trustee is as wide and sweeping as that of a trustee who is appointed upon adjudication.

2.1.2 Domicile Or Location Of Assets Within Jurisdiction

See 1.2 above. Domicile (namely, the location of the registered or principal office) is a general basis upon which a petition can be made to the court in whose jurisdiction is located the domicile. Location of assets is a valid ground only in Composition.

2.1.3 Eligibility For Relief; Excluded Entity

As discussed in 2.1.1.

2.1.4 Proof Of Good Faith Or Ability To Reorganize

This is a basic and written requirement. Despite the debtor's financial difficulties, it must have a reasonable prospect of rehabilitation through adjustment of the interests of its creditors, shareholders, and other persons interested.

2.1.5 Insolvency

Insolvency (defined such as inability generally to pay debts as they become due) is always a ground for commencement of reorganization. In addition, the likelihood of becoming insolvent or doubtful financial condition to be insolvency is a valid ground for Corporate Reorganization and Corporate Arrangement. The requirement is further broadened for Corporate Reorganization in that Corporate Reorganization can be commenced by a showing of a hardship in payment without impeding the continuation of business.

2.2 Requirement For Creditor(s) To Commence A Case

2.2.1 Proof Of Insolvency

The insolvency of debtor as shown above must be proved by all applicants, whether debtor or creditor.

2.2.2 Proof Of Improper Conduct Of Business

Proof of improper conduct of business *per se* is not made a separate ground for commencing a case. Improper conduct, such as concealing assets and abandonment of operations while having confiscated such assets is prima facie evidence of insolvency.

2.2.3 Proof Of Debt To Creditor Commencing Case

In order for a creditor to commence a Corporate Reorganization or Corporate Arrangement, it must be shown that the debtor is obligated to the petitioning creditor (or creditors) in the amount of at least 10% of its paid in capital. A single creditor may satisfy this requirement, and the debt can be secured or unsecured. A creditor may not commence a Composition.

3. **Parties To A Reorganization**

3.1 Judge

All reorganization is processed under the supervision of the court. This supervision continues until all of the terms or 90% or more of the terms of a plan have been completed in Corporate Reorganization or Corporate Arrangement, whereas in Composition the court's supervision terminates upon the confirmation of a plan. Japanese reorganization is under strong control by judges.

3.2 Fiduciaries (i.e. Trustees, etc.)

3.2.1 Debtor As A Theoretical Fiduciary

The trustee is the most important player in Corporate Reorganization. All powers and authority to operate the business and manage the property of the estate vest in him. By the same token, the management of the debtor is usually ousted from any of previous position. Corporate Arrangement is mostly processed by the debtor's management, although the court is always fully empowered to appoint an administrator to take over the responsibility for operation of business and management of assets. In a Composition, the debtor's management continues to operate the business and manage assets. Although always appointed, the responsibility of a Composition trustee is limited and restricted to giving

approval of transactions outside of the debtor's ordinary course of business.

3.3 Committees Of Creditors Or Holders Of Equity Interests

In a Corporate Reorganization, creditors and holders of equity interests form themselves into a meeting of interested parties. The interested parties are entitled to hear reports from the trustee, give opinions on operation of business and management of assets, and discuss and vote on a plan of reorganization. Confirmation of a reorganization plan requires a two-thirds vote of unsecured creditors with voting rights. In addition, the confirmation also requires the approval of at least three-fourths of those secured creditors having voting rights as to rescheduling of payment, and further the approval of at least four-fifths, with respect to the reduction of their principal or interest thereon. Holders of equity interests are not entitled to vote when the corporation's liability exceeds its assets. Apart from the meeting of interested parties, creditors and holders of equity interests may vote and elect its representative or representatives to act on their behalf. However, actual occurrence of this election is almost nil.

In a Corporate Arrangement, creditors do not form themselves in any manner. Their consent is sought by separate negotiation with the debtor. A plan of reorganization under arrangement, however, must be fair and viable, and must be approved in writing by 80-90% in amount of creditors, both secured and unsecured. A plan of payment under a Composition is submitted to a creditors' meeting for approval. Confirmation of a plan under a Composition requires votes in favor by a majority in number and more than three-fourths in amount of all unsecured creditors.

3.4 Government Administrators

In a Corporate Reorganization, after the petition is filed, the court gives notice to the proper government ministry or local government office, depending upon the nature of debtor's business. Notice will not be given in Corporate Arrangement or Composition.

3.5 Professionals: Accountants, Lawyers, Others

The interim trustee for Corporate Reorganization and Corporate Arrangement is always among lawyers. The court will normally appoint two trustees upon the order to

commence the proceedings, one of them is a lawyer and the other is a business person. Accountants are chosen by the interim trustee for investigation into the financial conditions of the debtor.

In a Composition, an inspector and a trustee are elected by the court, who are always lawyers.

4. Officers, Directors, and Affiliates

4.1 Personal Liability

4.1.1 Wrongful Trading

Corporate Reorganization and Corporate Arrangement have statutorily provided for a summary proceeding by which director/officer liabilities to corporation will be determined and an order to pay damages will be entered. Compositions do not have a similar proceeding. Outside of reorganization proceedings, as a general principle of corporate law, directors/officers are exposed to liability to creditors for wrongful conduct directly injuring creditors, or directly injuring the company, thus indirectly injuring creditors.

4.1.2 Taxes Owed By Entity

Directors/officers are not personally liable for taxes of the corporation, unless directors/officers are deemed to be the secondary tax payor to the corporation, for reasons such as they owned the corporation and bought the business of the corporation and so forth.

4.1.3 Wages, Employee Benefits Owed By The Corporation

Directors/officers are not personally liable for wages, employee benefits of the corporation, unless they are liable under 4.1.1.

4.1.4 Environmental Damage Caused By Entity

Directors/officers are personally liable for environmental damage, unless they are liable under 4.1.1.

4.2 Disregard Of Separateness Of Affiliated Entities

Disregard of corporate entity or piercing the veil is a well accepted principle of law developed in case law.

4.3 Subordination

In a Corporate Reorganization, subordination or at least different treatment of claims held by insiders or responsible management is well established. Courts have consistently maintained that different and unequal treatment of such claim holders are justifiable. Now it is becoming a principle to subordinate those claims held by insiders.

4.4 Insolvency-Related Crimes

Acts of concealing assets to defraud creditors, increasing of false debts, and neglecting to keep books of accounts are major reorganization crimes. Directors/officers are subject to special business fraud against the corporation provided in the Commercial Code.

4.5 Role In Reorganization

The most important role in reorganization is played by the trustee of Corporate Reorganization who obtains all court approvals, operates the business, manages assets, prepares a plan of reorganization and payment, and obtains consent to the plan from interested parties. In Corporate Arrangement and Composition, the same role with equal importance and responsibility is performed by the management of the corporation.

4.6 Selection Of Post-Reorganization Management

Post-reorganization is one of the terms to be set forth in a plan of reorganization and payment in a Corporate Reorganization. The terms are usually prepared after consultation with the judges and negotiated before the meeting of interested parties. In a Corporate Arrangement or Composition, such post-reorganization management usually is not provided for, because old management continues.