The Japanese Corporate Reorganization Reform Law of 2002

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I. Introduction

There are three types of reorganization laws, the Corporate Reorganization Law (*Kaisya Kosei Ho*), the Civil Rehabilitation Law (*Minji Saisei Ho*), and the Corporate Arrangement under the Commercial Code (*Kaisya Seiri*) in Japan. The Civil Rehabilitation Law (M*inji Saisei Ho*) is a new type of insolvency procedure introduced in 1999 and has become effective since April 1, 2000. This is a debtor in possession type procedure under the supervision of a court. To file a petition under this procedure is very popular among distressed Japanese debtors. Almost thirteen hundred cases were filed between April 2000 and September 2001. The Corporate Arrangement was introduced in 1938 in order for courts to formulate private workout of corporations. Since it required the corporate arrangement plan be approved by all creditors, few debtors file under this procedure now. The Corporate Reorganization Law, which was enacted in 1952 and reformed in1972, was reformed again and will become effective since April 1,2003.

II. The purpose of revising the Corporate Reorganization Law

One of the main reason for revising the Corporate Reorganization Law ("Law") is to make the Law easy to use both for debtors and for creditors. The strongest advantage to file a petition under the Law is to be able to bind secured creditors as well as unsecured creditors in the procedure. Other procedures, even one under the Civil Rehabilitation Law, cannot bind a secured creditor's execution. The number of filings under the Law was, however, from as few as four to at most 57 in each year during the last two decades. The reason for this relatively small number of filings is said to be that the procedure under the Law is too slow, too inefficient, and too inflexible. Also, the bankruptcy courts would restrict the debtors' filings; debtors were obliged, not legally but practically, to consult the bankruptcy court before filing a petition under the Law ("pre-counsel"). The purpose of the pre-counsel is to find cases where it is feasible to reorganize and help the debtor. For that reason, the court scrutinized filing documents deliberately before a debtor filed a petition. Sometimes, the court would reject to accept a filing because a debtor seemed to lack the ability to reorganize

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in the eyes of the bankruptcy judges. The newly reformed Law eases some of the legal requirements to file a petition, and makes the procedure more efficient and flexible (See III bellow). Whether the bankruptcy courts will continue this practice of conducting pre-counsel remains unknown at this stage.

III. Methods to streamline the procedure

The reformed Law loosens the requirements of opening cases, which means the bankruptcy court orders for relief[1]. While the possibility of reorganization was required under the pre-reformed Law, the reformed Law requires that when it is not apparent for a debtor either not to make a reorganization plan which includes the continuation of the debtor's business, or not to get an acceptance of the plan, or not to get a confirmation of the plan, then the court issues order for relief[2]. This helps a debtor to file a petition earlier. The Law also shortens the period of filing a reorganization plan so that it is now to take no more than one year from the time of issuance of the order for relief and in addition it curtails the period of installment payments term provided by the plan to 15 years after the conformation of the plan[3]. The reformed Law also makes it possible to shorten the case by closing the case after the debtor has paid more than two-thirds of the allowed claims under the confirmed plan[4]. The shorter the term is under the procedure, the smoother the debtor-creditor relationship is without being bothered by the debtor's stigma.

IV. Ways to utilize corporate reorganization procedures

Almost all the cases under the Law have been filed either with the Tokyo District Court or with the Osaka District Court. These courts have accumulated various

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[1] The procedure of the Law is quite different from that of Chapter 11 of the U.S. Bankruptcy Code. After filing a petition but before the order for relief (we call this a "gap period") an interim trustee, a bankruptcy lawyer, is designated by the bankruptcy court. This person examines the debtor's business and financial condition and continues to run its business. The Law does not know the concept of automatic stay. If the bankruptcy court is convinced that the requirements of order for relief are met, the court orders the relief, which allows the debtor to advance the procedure under the Law.

[2] See Art. 41.

[3] See Art.168. The pre-reformed Law allowed a debtor to take up to twenty years to execute a plan.

[4] See Art.239. Under the pre-reformed Law, the debtor was able to close the case only after the plan had been executed completely or was about to be executed completely. For this reason, a period of between ten and fifteen years was said to be necessary to close the case after the confirmation of the plan. This is too long a time for both a debtor and the creditors to endure.

kinds of know-how and information with respect to practicing the Law. To facilitate the filing of a petition, the Law allows the debtor to file a petition in either court as well as the court where the debtor's headquarters are located[5]. The court, upon the request of the parties interested or by its own motion, may order a comprehensive injunction[6]. This comprehensive injunction prohibits creditors, including tax authorities, from executing any of the debtor's assets compulsorily, during the period from filing a petition for the commencement of the case until the entry by the court of the order for relief. The comprehensive injunction functions similarly to the automatic stay in the U.S. Bankruptcy Code § 362 and relieves the debtor of the burden of having to seek individual injunctions in various courts within Japan.

To protect the depletion of the debtor's assets, and to facilitate business reorganization of the debtor, the court allows the debtor to sell all of or a part of its business before the plan is confirmed[7]. The court, however, cannot allow the sale if more than one-third of the amount of equities objects to the sale.

The Law accepts the concept of current value, instead of "going concern value," to estimate the debtor's assets[8]. This will eliminate the vagueness of the going concern value concept and establish the clear financial basis of the debtor's reorganization.

In this reformed Law, debtor's demand for the extinguishment of security interests is established like in the Civil Rehabilitation Law[9]. The court may allow

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[5] See Art.5.
[6] See Art.25-27.
[7] See Art.46. The pre-reformed Law only allows the sale of business through the execution of a reorganization plan.
[8] See Art.83. There was a long-time dispute about the concept of going concern value under the pre –reformed Law. The current value means the fair value of the assets. Depending on what the assets are, the fair value will be measured by their current cost, or their net realizable value, or the present value of their future cash flow.
[9] See Art.104. The purpose of demanding seems to be different from each other. With no ability to bind secured creditors under the Civil Rehabilitation Law, the debtors are obliged to negotiate with those creditors not to enforce their rights. However, secured creditors, such as banks and insurance companies, are reluctant to give this concession, given the existing economic recession in Japan. The debtor may demand that secured creditors extinguish their security interests by paying them an amount of money equal to the value of the secured assets, not an amount equal to the secured creditors' claim. This is especially effective for

the filing for extinguishment before the confirmation of the plan if it is required to reorganize the debtor.

V. How the procedure has been made easier

Contrary to the pre-reformed Law, the reformed Law automatically allows the debt, which is made before the order for relief but after the filing ("gap period" [10]), to become an administrative claim. This claim takes priority over other claims[11]. Even if the reorganizing debtor converts to the liquidation procedure under the Japanese Bankruptcy Law, the above debt keeps its first priority position under the title of "estate claim"[12]. These revisions are expected to facilitate the debtor in possession financing in Japan.

Also, before the revision of the Law debtor's management personnel were always ousted. This is one of the practical reasons why the number of filings has been relatively small under the Law. It is natural that the management of the debtor is reluctant to be fired after it decides to file a petition[13]. The reformed Law allows the court to appoint a member of the management to be a trustee as long as such a member seems to be free from any future damage claims by the debtor. It is like a debtor in possession type procedure. This revision helps the debtor's management to file a petition earlier under the Law.

The Law also loosens the requirement to vote for a reorganization plan[14].

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the debtor when the value of the asset declines. The court allows the extinguishment of security interests if the debtor's assets are indispensable to the continuation of the debtor's business. In contrast, under the Corporate Reorganization Law, secured creditors are bound in the procedure. They can enforce their secured interest only through the procedure like Chapter 11 of the U.S. Bankruptcy Code. One of the main reasons to establish this system is to reduce the administrative costs of retaining unnecessary assets as early as possible. This is why the requirements under either of the procedures are different.

[10] See footnote 1.
[11] See Art.128.
[12] See Art.11. The Japanese Bankruptcy Law (*Hasan Ho*) only deals with liquidation cases.
[13] The Civil Rehabilitation Law is the debtor in possession type procedure. This is the reason why many debtors decide to file a petition under the procedure, not under the Corporate Reorganization Law.
[14] See Art.196. Requirements for acceptance of the plan: a majority in value of the allowed unsecured claims; more than two-thirds in value of

VI. Providing information for interested parties

In order for the procedure to be transparent for the interested parties, the Law provides an efficient procedure to access documents relating the case that are reserved in the court[15]. The debtor should inform its creditors of the reason for its filing, about its business, its financial condition, and so on[16]. The court, upon request of the party interested, allows making an unsecured creditor's committee[17].

VII. Miscellaneous

The reformed Law provides the procedure for bondholders to vote for or against the plan[18]. The debtor's union is entitled to gives its opinion with respect to the court issuing the order for relief, and appointing a trustee[19].

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the allowed secured claims if the plan only extends the payment terms of the claims; more than three-fourths in value of the allowed secured claims if the plan includes reduction and/or exemption of the claims; nine-tenths in value of the allowed secured claims if the plan includes discontinuance of the debtor's business; majority in value of the equities.

[15] See Art.14,15.
[16] See Art.85.
[17] See Art 117.
[18] See Art.43, 190.
[19] See Art. 22, 85.