

CROSS BORDER INSOLVENCY – JAPAN

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1 Introduction

The Law on Recognition of and Assistance in Foreign Insolvency Proceedings (“LRAF”) and the Law to Amend a Portion of Civil Rehabilitation Law, etc. (“LACR”) were both enacted on November 21, 2000, and have been in effect since April 1, 2001. UNCITRAL made a Model Law for cross-border insolvency in May 1997, and the general assembly of the United Nations resolved that the Model Law be introduced to the member countries’ domestic laws. In accordance with such resolution, Mexico and some other countries have already introduced the Model Law into their local laws.

However, in Japan, the Bankruptcy Law and Corporate Reorganization Law had adopted strict territoriality, under which the effects of bankruptcy or corporate reorganization proceedings commenced in Japan do not extend to assets located in foreign countries, and *vice versa*. Bankruptcy Code, Section 3, Corporate Reorganization Law (“Corp. Reorg. Law”), Section 4

Naturally, such territoriality has been criticized by the “users” of the proceedings, as well as international bankruptcy practitioners. It has long been desired that internationally harmonized insolvency proceedings be introduced.

Under such circumstances, the Civil Rehabilitation Law (“CRL”), that was enacted in 1999 and has been in effect since April 1, 2000, adopted the universality principle with regard to the outbound effect of CRL proceedings, whereas the inward effect was left unchanged with the territoriality principle. CRL, Sections 4, 38.1

The LRAF and LACR were enacted in order to abolish rigid territoriality, as well as to introduce procedures to recognize foreign insolvency proceedings based upon the Model Law of UNCITRAL. By such amendments, it is broadly expected that the insolvency proceedings of Japan will be able to be handled in smooth cooperation and harmonization with foreign insolvency proceedings.

2 Outline of LRAF

2.1 Recognition and Assistance

(a) Steps toward recognition and assistance

The LRAF does not grant any right or privilege to a foreign representative by his merely obtaining recognition of the foreign proceeding. The foreign representative must file a petition for appropriate assistance on a case by case basis, and obtain a court order for such assistance.

(b) Petition for recognition

A foreign representative (including a DIP) is entitled to file a petition for recognition of the relevant foreign insolvency proceeding. LRAF, Section 17.1

The foreign representative may file a petition for recognition of the foreign insolvency proceeding and also for a court order for assistance, even prior to the formal commencement of the foreign proceeding. LRAF, Section 17.2

(c) Recognition order

The court will render a recognition order if it is convinced that the foreign insolvency proceeding is qualified for assistance within Japan. LRAF, Section 22.1

In order for the foreign proceeding to be deemed qualified, the following requirements must be met:

- (1) (1) The debtors' address, residence, or business or other office exists in the country where the relevant foreign insolvency proceeding is pending. LRAF, Section 17.1
- (2) Commencement of the foreign insolvency proceeding has been formally ordered. LRAF, Section 22.1
- (3) None of the following causes for rejection exists:
 - (i) (i) That the procedural deposit has not been deposited (LRAF, Section 21(1));
 - (ii) (ii) That it is clear under the foreign proceeding that the effect of such proceeding does not extend to assets located within Japan (LRAF, Section 21(2));
 - (iii) (iii) That providing assistance toward the foreign proceeding violates the public order of Japan (LRAF, Section 21(3));
 - (iv) (iv) That it is clear that no assistance is necessary under LRAF for the foreign insolvency proceeding (LRAF, Section 21(4));
 - (v) (v) That the foreign representative has failed to make a report to the court in regard to the status of the development of the foreign insolvency proceeding, except where the violation is immaterial (LRAF, Section 21(5));
 - (vi) (vi) That the petition has clearly been filed for undue objectives or in bad faith. (LRAF, Section 21(6))

(d) Assistance order

Where a recognition order has been rendered, the following assistance orders may be rendered in accordance with necessity.

- (1) A temporary suspension order against a compulsory execution proceeding upon judgement, or provisional attachment or other injunction, lawsuit or administrative proceeding, with regard to the debtors' assets in Japan. LRAF, Section 25.1
- (2) Cancellation order against compulsory execution proceedings - the proceedings may be cancelled depending upon necessity. LRAF, Section 25.5
- (3) A temporary suspension order against an auction proceeding as foreclosure of a lien. LRAF, Section 27.1
- (4) Prohibition order against compulsory execution - the court may, upon necessity, render a prohibition order against compulsory execution in respect of all the creditors. LRAF, Section 28.1
- (5) Injunction prohibiting debtor from disposition of assets and payments

- the court may render such orders and other appropriate orders. LRAF, Section 26.1

- (6) Administration order - the court may, whenever it deems it necessary, at the petition of a party in interest or at its discretion, order that the debtors' business and assets within Japan be administered by a recognized trustee. LRAF, Section 32.1 Where such administration order has been rendered, the power and authority to manage the debtor's business and to dispose of its assets within Japan, shall be exclusively vested in the recognized trustee. LRAF, Section 34
- (7) Provisional administration order - the court may render a provisional administration order when it is convinced that there is an emergency necessity. The provisional administration order grants power and authority to the interim trustee exclusively with regard to the business and assets of the debtor within Japan. LRAF, Section 51.1 This order may be granted only where this order is specifically required to attain the goal under the LRAF of recognition and assistance. The interim trustee is required to obtain a specific court order where it wishes to conduct any transaction that is out of the ordinary course of business. LRAF, Section 53.1

(e) Disposition or outbound delivery of local assets

The distribution of assets under the foreign insolvency proceedings may not always be made in accordance with the same priority as the Japanese insolvency proceedings. Accordingly, the court may, in order to protect local creditors, order that the DIP shall obtain the courts' approval for disposition or outbound delivery of the debtors assets within Japan. LRAF, Section 31. Also, a recognized trustee must obtain the courts' approval to do the same thing. LRAF, Section 35.

(f) Termination of LRAF proceeding

The LRAF proceeding shall terminate upon cancellation of the order of recognition of the foreign insolvency proceeding. LRAF, Section 56. Recognition shall be cancelled in the event that the foreign insolvency proceeding has terminated or the requirement for recognition of the foreign insolvency proceeding is found to be nonexistent. The recognition of the foreign insolvency proceedings may also be cancelled in the event that the DIP or recognized trustee has disposed of, or delivered out of Japan, the debtor's assets, if the DIP or recognized trustee has violated the requirement for court approval to do so. LRAF, Section 56.2

2.2 Harmonization of LRAF proceeding and other insolvency proceedings

LRAF adopted the principle that a debtor shall be subject to only one insolvency proceeding. Thus, when a LRAF proceeding and a local insolvency proceeding, or two or more LRAF proceedings, are petitioned with regard to a debtor, such petitions shall be handled in accordance with the following principle:

- (a) Local insolvency proceeding shall prevail over LRAF proceeding, in general.

(b) In the case where the LRAF proceeding is (1) for the foreign main proceeding*, (2) providing assistance to such foreign insolvency proceeding conforms to the general interests of creditors, and (3) providing assistance to such foreign insolvency proceeding will not unduly impair the interests of creditors within Japan, LRAF proceeding shall prevail over local insolvency proceeding. LRAF, Sections 57 to 60

* In the case of a commercial debtor, the foreign insolvency proceeding, that has been petitioned in such motion, where the debtor holds its main office of business. LRAF, Section 2. (2)

(c) LRAF proceeding in respect to the foreign main proceeding shall prevail over those with respect to a foreign non-main proceeding. LRAF, Sections 62, 63

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

3 Outline of LACR

3.1 Abandonment of territoriality

Civil Rehabilitation Law has already abandoned outbound territoriality since its enactment in 1999, and enforcement from April 1, 2000. By the enactment of LRAF and LACR, territoriality principle has been abandoned in relation to the inbound effect under CRL, and also in such insolvency proceedings as bankruptcy and corporate reorganization.

As a result, the effect of the bankruptcy proceeding now extends to the debtor's assets located outside of Japan, and the authority of an interim trustee and trustee extends to the debtor's assets located outside of Japan. Bankruptcy Code, Sections 3 (deleted), 6.1; Corp. Reorg. Law, Sections 4 (deleted), 40.1, 53.

3.2 Hotchpot rule - Section 89 of CRL has already adopted the hotchpot rule, under which any recovery of a creditor, made by exercising its rights, from the debtor's assets located outside of Japan shall be credited against payment under the CRL proceeding. The same rule has been introduced to bankruptcy and corporate reorganization proceedings. (Bankruptcy Code, Sections 23-2, 265-2, 306-2, 326-2; Corp. Reorg. Law, Sections 118-2, 124-3)

3.3 International jurisdiction

It has been made clear that the Japanese court has jurisdiction over an insolvency case, as long as the debtor has either address, residence, business or other offices, or assets, in the case of a bankruptcy or CRL proceeding, or has its business offices, in the case of a corporate reorganization, within Japan. (Bankruptcy Code, Section 104-2, CRL 4-2; Corp. Reorg. Law, 5-2)

3.4 Special provisions for harmonization with foreign insolvency proceedings

CRL has already introduced various provisions in order to harmonize the CRL proceeding with foreign insolvency proceedings, and LACR introduced similar provisions to the Bankruptcy Law and Corporate Reorganization Law.

- (a) Trustees in bankruptcy and corporate reorganization proceedings are to cooperate with foreign trustees mutually. (Bankruptcy Code, Section 357-2; Corp. Reorg. Law, Section 289-2)
- (b) Causes for commencement of bankruptcy proceedings are assumed where a bankruptcy or other insolvency proceeding is pending in a foreign country. Also, causes for commencement of corporate reorganization proceeding are assumed where any insolvency proceeding is pending in a foreign country. (Bankruptcy Code, Section 131-2; Corp. Reorg. Law, Section 289-3)
- (c) Foreign trustees are vested with the right to file a petition for a local insolvency proceeding, and to attend the creditors meeting to express his/her opinion under the domestic insolvency proceedings. (Bankruptcy Code, Section 357-3; Corp. Reorg. Law, Section 289-4)
- (d) Trustees are entitled to participate in foreign insolvency proceedings on behalf of the creditors who are participating in the bankruptcy or corporate reorganization proceedings, and vice versa. (Bankruptcy Code, Section 357-4; Corp. Reorg. Law, Section 289-5)

3.5 Abandonment of mutuality

LACR eliminated the *proviso* to Bankruptcy Code Section 2 under which the mutuality principle was applicable. By eliminating the *proviso*, the new bankruptcy law provides equal treatment to foreign parties regardless of whether such foreign party's home country provides national treatment to a foreign party.

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