

# Insolvency and Restructuring in Germany

Yearbook 2010

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## Statutory Procedures, Out of Court Workout, Quasi-Governmental Organizations and Other Devices in Japan to Revitalize Ailing Business Corporations

By Dr Shinjiro Takagi, former Judge of Tokyo District Court

The downturn of real economy may hit its bottom in the near future, but its recovery may take “L” letter-shaped rather than “V”-shaped. Many business corporations may have to resolve excess-capacity problems to match reduced consumer demands. Compared to declined gross sales, some parts of existing debts owed by many business corporations may become excessive. Without revitalizing these business corporations by means of debt restructuring, another economic crisis may recur.

### 1. Insolvency Law Reforms and Expedited Practice in Japan

*Changes in reorganization*

Significant changes in reorganization occurred in Japan between late 1990s and early 2000s. The Civil Rehabilitation Law was enacted in 1999 to replace previous Composition Law of 1922. This was followed by series of changes in bankruptcy related laws, such as (1) the enactment of the new Law for Recognition and Assistance for Foreign Insolvency Proceedings adopting UNCITRAL Model law in 2000; (2) the enactment of the new Corporate Reorganization Law (CRL) in 2002 replacing previous CRL of 1952; (3) the enactment of the new Bankruptcy Law (BL) in 2004 replacing previous BL of 1922; and (4) the enactment of the new Company Law which includes many new tools to facilitate reorganization of healthy and distressed business corporations in 2005. The new Company Law also revised provisions regarding the Special Liquidation Proceeding. Chapter 4 of the Revised Act on Special Measures for Industrial Revitalization (RASMIR) of 2007 enabled to establish the Business Reorganization ADR mentioned below.

*Speedier handling of bankruptcy cases*

Along with the above legal reforms, the Japanese courts have wide-opened their gates to rehabilitation and reorganization cases, that are being handled more speedily. The handling of the Bankruptcy cases has been speeded up. In civil rehabilitation cases in Tokyo, a plan will be generally confirmed by the court about six months after the filing of a petition to open the case. In corporate reorganization cases, which are generally larger in size than the civil rehabilitation cases, a plan will be generally confirmed within one year after the commencement of the case.

In the past ten years, a lot of private equity funds which target distressed companies were created and advisory/consulting/turnaround firms specialized in rehabilitating distressed businesses became widespread in Japan.

### 2. Civil Rehabilitation and Corporate Reorganization Proceedings

Major differences between Civil Rehabilitation and Corporate Reorganization proceedings are follows:

- (1) Civil rehabilitation proceeding is designed to rehabilitate small and medium-sized enterprises (SMEs) in general whereas corporate reorganization proceeding is to reorganize larger undertakings;
- (2) In a corporate reorganization case, rights of secured creditors are stayed and secured claims can be altered under a corporate reorganization plan which is accepted by the majority of creditors; to the contrary, in a civil rehabilitation case, secured creditors' rights can neither be stayed nor altered without consent of individual secured creditors (with some exceptions as explained later);
- (3) In civil rehabilitation proceedings, a debtor is not principally deprived of its right to operate the business and dispose of its assets whereas incumbent managers are replaced by a trustee in a corporate reorganization case in principle. The new Corporate Reorganization Law in 2002, however, provides that a court is able to appoint one or several incumbent managers as (deputy) trustee(s) in some cases partly adopting the debtor in possession (“DIP”) system.

### 3. Guideline for Out-of-Court Workout

The National Bankers Association, the Federation of Managers of Business Corporations, and other relevant organizations associated with Financial Services Agency, Ministry of Finance, METI, Bank of Japan and the Deposit Insurance Corporation, created a committee that established the Guideline for Out-of-Court Workout in September 2001. The Guideline, that references the INSOL 8 principles for international multi-creditors' workout, was designed to clear out the huge amount of NPLs owed to multiple banks and financial institutions and restore the viability of the debtor corporations.

*Guideline for Out-of-Court Workout*

#### (1) Process of Out-of-Court Workout based on the Guideline

The procedure established by the Guideline begins with the debtor corporation applying together with its “main bank” for a multi-creditor out-of-court workout in cases where a number of financial creditors possess lending exposures. The application must be accompanied by documents that describe the causes of the debtor becoming financially distressed and a proposed reorganization plan. The proposal should include not only a business reorganization plan but also a debt restructuring plan. The “main bank” then investigates the documents and the reorganization plan to determine whether the descriptions and statements are accurate and the proposed plan is both feasible and reasonable. If the “main bank” determines that these criteria are met and agrees that the plan can be acceptable to all other non-main banks whose debts are to be forgiven under the reorganization plan, it will issue a notice of “standstill” to all other “relevant financial creditors” and convene the first meeting of creditors. The “relevant creditors” are those creditors whose claims are requested to be waived in the proposed plan: they usually consist of banks and other financial institutions, but trade creditors with significant exposures may be included in the category of “relevant creditors” when the waiver of their trade claims are necessary to accomplish effective debt restructuring. This meeting must be held within two weeks after the notice of standstill was issued.

*“Main bank”*

*Electing a  
creditors'  
committee*

At the first meeting of creditors, unanimous consent of the creditors must be obtained to extend the standstill period. If they all agree, then a creditors' committee may be elected. The committee can designate professionals (including lawyers, accountants and consultants) to examine the accuracy of the financial statements and the reasonableness and feasibility of the proposed reorganization plan. During the standstill period, the relevant creditors shall refrain from any collection efforts; enforcement or realization of secured rights; improvement of their exposures in relation to other relevant creditors; and maintain the original balance of their claims. Before the end of the third month after the first meeting, a second meeting must be held at which all relevant creditors are to indicate whether they accept the plan or not. If all creditors whose rights will be impaired by reorganization plan consent to the proposed plan, the reorganization plan becomes authorized and the debts owed to the relevant creditors will be changed according to the provisions contained in the plan. If one or more of the creditors refuses to agree to the plan, the out-of-court workout process is terminated and the debtor should decide whether to file a petition with a court to begin statutory insolvency proceedings.

*(2) Requirements for a Reorganization Plan**Guideline*

The Guideline is designed to facilitate multiple financial creditor workouts to rehabilitate corporations burdened with huge amounts of debts. In contrast to the INSOL 8 principles, the Guideline provides for substantial requirements for the reorganization. If the debtor is insolvent, which means that the total amount of debts exceed the total value of assets, the proposed plan must provide feasible measures to resolve the problem within three years. If the debtor has an operating loss, the plan must also show how that loss will be transformed into a profit within the three-year period. The plan should provide that the equity of the debtor's controlling shareholders should, in principle, be wiped out and divested, and the equity of existing shareholders should be diluted substantially or eliminated altogether through stock retirement and subsequent capital increase. The plan should, in principle, also request that the debtor's incumbent managers resign upon the creditors' acceptance of the proposed plan.

*4. Resolution & Collection Corporation*

The Resolution & Collection Corporation ("RCC") was established by the Japanese government in 1996 to take over loan assets owned by bankrupt housing loan companies and subsequently reformed in 1999, merging another special purpose company which was established in 1995 to buy loan assets of bankrupt financial institutions, for the express purpose of buying non- and sub-performing loans ("NPLs") from financial institutions including solvent banks and collecting these debts in order to accelerate removal of significant amount of NPLs from the banks' balance sheet. The RCC has not only tried to enforce actions against bad and doubtful debts, but also it has actively advised distressed debtors in restructuring their debts and businesses by means of out-of-court workouts and statutory reorganization proceedings (i.e., civil rehabilitation and corporate reorganization proceedings). Although their deadline to purchase bad assets has expired at the end of March 2005, the RCC continues to help debts restructuring

of nonviable loan assets entrusted by financial institutions but without buying the loans anymore.

*5. Industrial Revitalization Corporation of Japan*

The IRCJ was created in May 2003 by the Japanese Government to dispose of non- and poorly-performing loans as well as to revitalize ailing companies with excessive debts to overcome prolonged recession that lasted over ten years.

The IRCJ rescued 41 enterprise groups consisted of nearly 200 companies by March 2005 and dissolved itself in March 2007 one year earlier than was scheduled.

Upon receiving an application made by a company and its main bank holding the biggest exposure to the debtor company, the IRCJ conducted due diligence and developed operational and financial restructuring plans. Then, the IRCJ proposed to buy debts owed to financial institutions or requested to accept the debt restructuring plan by means of partial debts forgiveness and/or debts equity swaps as stipulated by the proposed plan. After the solicitation made by the IRCJ, most of financial creditors either sold their debts to the IRCJ or accepted the plan. Outstanding stocks were wiped out or diluted in most cases and the IRCJ infused new equity into the company. The IRCJ sent hands-on turnaround managers replacing incumbent managers and operated the debtors' business.

*Conducting due  
diligence, planning  
operational and  
financial  
restructuring*

Within one or two years since the opening of each case, the IRCJ sold the purchased debts and/or equities to new owners by means of M&A.

The IRCJ was financed by a governmental guarantee and successfully closed its business with profit.

*6. Small and Medium-sized Enterprises Turnaround Associations*

In 2003, under the initiative of the Ministry of Economy, Trade and Industries ("METI"), the SME Turnaround Associations were created in all 47 municipalities and prefectures in Japan for the purpose of assisting debt restructuring of small and medium-sized enterprises. Professional staff at the Associations are advising ailing SMEs on how to turnaround their business operations and draft debt restructuring plans at the request of debtor companies with excessive debts. The Associations also take the role of an intermediary between the debtor and financial creditors to work out the drafted restructuring plan. The Associations have advised a huge number of enterprises.

*Debtor-creditor  
mediation*

*7. Newly started Business Reorganization ADR*

The Business Reorganization ADR (Alternative Dispute Resolution) was created by the Japanese Association of Turnaround Professionals (JATP) last November with the approvals of Ministry of Economy, Industry and Trade, and the Ministry of Justice based on the aforementioned RASMIR of 2007. Turnaround experts, who were appointed in each case by the selection committee of JATP that is

chaired by me, preside workout using fair rules which are similar to the Guidelines. The BRADR started its business this March and has been handling several big reorganization cases, including public companies. The government-owned organizations may guarantee substantial part of debts owed by a debtor during the workout process as DIP financing. In cases where unanimous consents could not be reached, the debtor may file a court-administered mediation proceeding and the court may issue an order which recommend the holdout creditors to accept the proposed plan with possible amendments. If the creditors do not object to the order within two weeks, the order becomes effective to bind the relevant parties. If the creditors object to the order, the debtor should convert the case to a statutory reorganization proceeding in which the proposed plan may be treated as a pre-negotiated plan.

#### 8. Creation of the Enterprises Revitalization Assistance Corporation in Japan

*Options for restructuring corporations*

The bill to establish a new quasi-governmental corporation to assist revitalization of ailing companies became a law on 19 June 2009 and the new corporation is expected to be created before the end of coming September. The new law is similar to the IRCJ law with minor amendments. Main targeted companies are medium-sized corporations whose failure may have adverse impact on local economies. Other small and medium-sized companies can be reorganized assisted by SMEs Turnaround Associations which were created in 47 prefectures in 2003, the year in which the IRCJ was created. Larger corporations could be reorganized by expedited workout without the purchase of debts by the public sector, possibly assisted by the aforementioned BRADR. For the purpose to infuse new money in distressed SMEs, there are regional funds which are created to help revitalization of local enterprises in each prefectures as well as private equity funds which are specialized to invest in distressed companies. In addition to new ERAC, we have several options to restructure business corporations in Japan such as (1) expedited statutory reorganization procedures supervised by courts, (2) aforementioned new BRADR, (3) SME Turnaround Associations, (4) Enterprises Restructuring Group of the Resolution & Collection Corporation, (5) local restructuring funds in every 47 prefectures, and (6) private equity funds specialized in investing in distressed corporations, etc. This competitive environment might have contributed to improve professional expertise to restructure distressed corporations in Japan.

#### 9. Providing Loans and Equities to Larger Business Corporations

Larger corporations are going to be saved through provision of loans and/or infusion of equities by the Development Bank of Japan under the guarantee of the Japanese Government according to the special emergent legislation which was enacted at the end of April 2009.

Shinjiro Takagi has been advisor to Nomura Securities Co. Ltd. since 2007. He was admitted to the Japanese bar in 1963. After being in private practice for 25 years, he was appointed Judge of Tokyo District Court in 1988. In 1995 he became President and Chief Judge of Yamagata District & Family Court, and in 1997 he was appointed President and Chief Judge of Niigata District Court. From 1998, he was Presiding Judge of Tokyo High Court (Court of Appeal); he retired from public service in 2000. After resuming private practice, he successfully reorganized numerous big business corporations. He was the chairperson of the Committee for Guidelines of Multi-Creditors Out-of-Court Workout organized by the National Bank Association, the Federation of Economic Organizations and other organizations in 2001. He was also the chairperson of the Advisory Committee for Reforming Corporate Reorganization Law at the Ministry of Economy Industry and Trade in 2001. He founded the Japanese Association of Business Restructuring, the Japanese Association of Turnaround Professionals, the Japanese Federation of Insolvency Practitioners (INSOL Japan) and the National Network of Bankruptcy Lawyers in 2002 to 2003. He was Professor at Chuo University Law School from 2003 to 2006. He was Chairman of the Industrial Revitalization Commission for the Industrial Revitalization Corporation of Japan from 2003 to 2007. He has been a member of the board Governors at the International Insolvency Institute since 2004 and a fellow of the American College of Bankruptcy since 1998. He received an award from the International Insolvency Institute in recognition of his outstanding service and contribution to international insolvency in 2005. He received the Order of the Rising Sun, Golden and Silver Star awarded by Japan's Emperor in 2007. He has written numerous books and articles on bankruptcy law and civil procedure in Japan and the USA. He became a doctor of law in 2002.