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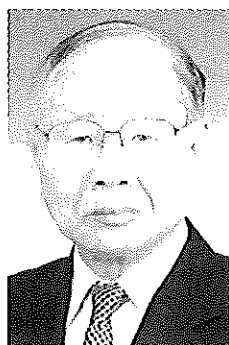
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Cross-Border Insolvency in Japan



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Insolvency laws in Japan are slowly catching up with the introduction of a law based on the UNCITRAL Model Law.

Law on Recognition of and Assistance in Foreign Insolvency Proceedings

The insolvency laws of Japan were slow in catching up with the globalisation of economic activities. The Bankruptcy Law and the Corporate Reorganisation Law explicitly provided for territoriality, declaring that any proceedings commenced in Japan pursuant to these Laws did not affect the debtor's assets located outside the country and that any insolvency proceedings commenced in a foreign country had no effect on the debtor's assets in Japan. As cross-border business expanded, it became clear that the strict application of these rules could lead to inappropriate results. Although efforts were made to alleviate the shortcomings of territoriality through wide interpretation of these two Laws, such an approach had only limited effect in resolving the problem.

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Motivated by the expansion of cross-border business and by criticism from other countries, Japan introduced new legislation to cope with cross-border insolvency issues based on the UNCITRAL Model Law on Cross-Border Insolvency. The Law on Recognition of and Assistance in Foreign Insolvency Proceedings (LRAF) was enacted in November 2000 and entered into effect on 1 April 2001.

Procedures for acquiring recognition

Under the LRAF, the trustee (the debtor in case of debtor-in-possession proceedings) of a foreign insolvency proceeding (the 'Foreign Representative') may apply to the court for recognition of the foreign proceeding (the 'Foreign Proceeding'). The Tokyo District Court has exclusive jurisdiction over recognition proceedings under the LRAF. On filing, the Foreign Representative must prove that the debtor's residence or office is located in the country in which the Foreign Proceeding was filed. A deposit of procedural fees, the amount of which is determined by the court, is also required on filing.

A commencement decision of the Foreign Proceeding is not necessary for the filing of application, but such decision needs to have been rendered by the foreign court for the Tokyo District Court to issue an order of recognition.

The court considers the application based on the application and supporting documents submitted by the Foreign Representative. The court may conduct additional investigation if necessary. After due consideration, the court will issue an order of recognition unless it finds any of the following grounds for dismissal:

- (1) it is clear under the Foreign Proceeding that the effect of such Proceeding does not extend to the debtor's assets located in Japan;
- (2) providing assistance in the Foreign Proceeding would violate the public order of Japan;
- (3) it is clear that there is no need to render assistance to the Foreign Proceeding;
- (4) the Foreign Representative fails to report the status of the Foreign Proceeding as required by the court; or
- (5) it is clear that the application was filed for an illegitimate purpose or otherwise not made in good faith.

In addition to the above, the court may not issue a recognition order in certain cases where other insolvency proceedings are ongoing. The applicable rule in such instances of concurrent proceedings is described later in this article.

Measures for assistance

The recognition order does not produce any direct effect in itself, but becomes the basis of measures that may be taken by the court to assist the Foreign Proceeding.

One of the most important measures is the issue of an administration order through which the court appoints a trustee (the 'Recognition Trustee') to assume control of the business and assets of the debtor in Japan. The court may issue such an order when it deems it necessary to attain the purposes of the LRAF proceedings. It is anticipated that the Foreign Representative will usually be appointed as the Recognition Trustee, thereby obtaining a legal status in Japan to achieve the purposes of the Foreign Proceeding. The Recognition Trustee is given exclusive authority to administer the business and assets of the debtor in Japan, subject to supervision by the court. The court's control over the Recognition Trustee is exercised by requiring court approval for the disposal of the debtor's assets or

removal of said assets from Japan, and by imposing an obligation on the Recognition Trustee to report the status of its administration work to the court. Furthermore, the Recognition Trustee owes a duty of care and is liable for damages incurred by interested parties if it violates such duty. Once appointed, the Recognition Trustee has the sole authority to represent the debtor in lawsuits or administrative proceedings concerning the debtor's assets. Before the enactment of the LRAF, Japanese courts had interpreted that trustees in foreign insolvency proceedings were permitted to represent the debtor in litigation concerning the debtor's assets based solely on their status in the foreign proceedings. As a result of the new law, however, it is considered that all foreign trustees need to acquire the status of Recognition Trustee in order to become parties to such actions.

In addition to the administration order, the court may:

- (1) generally prohibit compulsory execution, provisional attachment or preliminary injunction ('Execution Procedures') against the debtor's assets if such prohibition is necessary to attain the purposes of the LRAF proceedings;
- (2) cancel Execution Procedures already taken against the debtor's assets if deemed especially necessary; and
- (3) suspend foreclosures of security interests in the debtor's assets, provided that the suspension is consistent with the general interests of the creditors and does not cause undue damage to the secured creditor.

Interim measures

The court may, prior to issuing a recognition order, also take such measures as:

- (1) issue of a provisional administration order;
 - (2) suspension of Execution Procedures, lawsuits or administrative proceedings taken against the debtor's assets;
 - (3) prohibition of the disposal of assets or payment of debts; and
 - (4) suspension of foreclosures as mentioned above.
- All of these measures except for the provisional administration order continue in effect after the issue of the recognition order. In cases in which permanent assistance measures are expected to be obtained easily, there may be little need to apply for these interim measures. However, the interim measures may be useful in cases where there are special circumstances that prevent the timely

acquisition of the recognition order and the administration order.

Termination of LRAF proceedings

The LRAF proceedings are terminated by court order on the termination of the Foreign Proceeding or on finding that one or more of the grounds for rejection of recognition, such as the absence of necessity for rendering assistance, exists. In addition, the court may, at its discretion, terminate the LRAF proceedings if:

- (1) the Foreign Representative who was appointed as Recognition Trustee conducts an act requiring court approval without obtaining approval, such as disposal of the debtor's assets or removal of such assets from Japan or fails to report to the court as required;
- (2) the Foreign Representative who has not been appointed as Recognition Trustee disposes of the debtor's assets or removes such assets from Japan; or
- (3) in case a Recognition Trustee is not appointed, the debtor conducts an act requiring court approval without obtaining approval.

Concurrent proceedings

In order to avoid confusion and discrepancy when more than one insolvency proceeding or LRAF proceeding is taking place concurrently in Japan with regard to the same debtor, the LRAF sets out rules providing for priority of the proceedings. First, in the event that a Japanese insolvency proceeding is pending, such proceeding *prima facie* has priority over any foreign insolvency proceeding; the court therefore will not, in principle, recognise the

Foreign Proceeding. However, if the court finds that the Foreign Proceeding is a foreign main proceeding, ie the debtor's main office is located in the country where the Foreign Proceeding was filed, and that the provision of assistance is consistent with the general interests of creditors and does not unduly disturb the interests of creditors in Japan, the court may recognise the Foreign Proceeding and take measures to assist the proceeding. In such a case, the Japanese insolvency proceeding will be suspended. Secondly, in case there is more than one application for recognition of a foreign proceeding, priority is always given to the foreign main proceeding. If none of the foreign proceedings is a main proceeding, then priority is determined in accordance with the general interests of creditors. Any ongoing LRAF proceeding which is not given priority will be suspended.

UNCITRAL Model Law

As seen above, the LRAF has adopted most of the proposals in the UNCITRAL Model Law with regard to the provision of assistance towards foreign insolvency proceedings. This new Law, together with the other two pieces of legislation mentioned at the beginning of this article, have established the basis of a system well-equipped to cope with cross-border insolvencies which will undoubtedly continue to increase. Now that the framework has been founded, the next ingredient is the efforts of all parties concerned, especially the court and insolvency practitioners, to manage and utilise the system in such a way as to achieve its purpose: fair and efficient administration of cross-border insolvencies. ■