JAPANESE INSOLVENCY LAWS

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I. JAPANESE INSOLVENCY LAWS IN GENERAL

Japan is a civil law country. Its Civil Code, Commercial Code and other basic statutes were enacted between the late 19th century and early 20th century and were heavily influenced by, mainly, German and, partly, French statutes.

The Bankruptcy Code, to some extent, and Composition Act were enacted in 1922 and are based upon the German Bankruptcy Code and Austrian Composition Act which were in effect at that time. The bankruptcy proceeding provided by the Bankruptcy Code is used to liquidate estates of every type of legal entity and of individuals, whereas the composition process provided by the Com-

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position Act can be utilized not only for liquidation but also for rehabilitation purposes for every type of legal entity and for individuals as well.

Despite the enactment of the Bankruptcy Code and the Composition Act, these statutory bankruptcy and composition proceedings were unpopular because of their complexity and other reasons. Thus, a lot of insolvent corporations and individuals were liquidated and reorganized by out of court workouts, called "hin-i-seiri" or "shiteki-seiri." "Seiri" means arrangement, "nin-i" means not compulsory, and "shiteki" means private. In a shiteki-seiri or out-of-court workout, there is, however, some risk of injustice or inequity. For example, some powerful creditors or "seiri-ya" might receive unfair benefits to the detriment of general creditors. "Seiri-ya" are the professional extra-legal groups who provide such services, and "Sokai-ya" are those involved in the liquidation or rehabilitation process of insolvent business entities.

To preclude the potential injustice and inequity that can occur in extra-legal proceedings, the Corporate Arrangement and the Special Liquidation proceedings were introduced by inserting sections 381 to 416 into the Commercial Code in 1958. Prior to the enactment of the Corporate Arrangement and the Special Liquidation proceedings, some comparisons of the Japanese process might have been made to English deeds of arrangement and compulsory winding-up proceedings. However, the Corporate Arrangement and the Special Liquidation proceedings are uniquely Japanese proceedings and create a quite different system compared with the English proceedings mentioned above.

After World War II, many important amendments were made to many statutes, and new legislation, including the enactment of the New Constitution, was made pursuant to the orders of General MacArthur, the Supreme Commander for the Allied Occupation Powers. Law reforms related to commercial and business matters, including the reform of business corporations by amending the Commercial Code, were made to encourage foreign investments in Japan. Important changes to insolvency laws included the enactment of the Corporate Reorganization Act and the amendment of the Bankruptcy Code by inserting Sections 366-2 through 366-20, which create a discharge system following the bankruptcy of natural persons. The Corporate Reorganization Act was modeled partly after Chapter X of the former Title 11, U.S. Bankruptcy Code of 1898, with modifications to conform to the Japanese legal system. However, Japanese practice for Corporate Reorganization proceedings is quite different from that of the former Chapter X due to different business customs. It took many years before the Anglo-American discharge system was utilized by the public in a widespread manner, particularly after the 1980s, due to the popularity of credit cards and easy access to consumer-loans.

Therefore, although Japanese insolvency laws are largely based on those of civil-law countries, the Corporate Reorganization proceedings and Bankruptcy Discharge System are mingled hybrids of civil-law and common-law systems.

II. PROMISSORY NOTES IN JAPAN

In Japan, promissory notes are widely used to pay debts incurred in business and commercial transactions. Purchase money of commodities for resale and materials to be processed or manufactured, fees or compensation for services rendered by subcontractors, manufacturers and others are usually paid by promissory notes, signed and sealed by debtors monthly. A promissory note will be paid at the bank designated on the face of the note on the maturity date, which is a fixed date designated to be some day between 3 and 6 months after the issue date, and is written on the face of the note. Due to the popularity of promissory notes, business entities need no money on hand to buy commodities, materials and services. Retailers can repay their issued notes from proceeds received from resale of commodities purchased from wholesalers, and manufacturers are able to repay their notes for raw materials from proceeds from completed and sold products on the maturity date, which may be 4 or 7 months after when they bought the raw materials. Similarly, manufacturers receive promissory notes for the purchase of completed products by their customer-merchants, which the manufacturers would in turn sell to banks at a discounted rate, using the proceeds to pay their own outstanding notes. The discounted rate is determined by the length of the term from the day the note is discounted to the maturity date, and by the creditworthiness of the issuer. In other words, the rate of discount is lower where the likelihood of being repaid is higher.

One of the secret reasons why Japan was able to restore its economic prosperity after World War II may be promissory notes. At the end of the war, most of Japan's major cities had been left destroyed by bombs. Promissory notes became very popular as means of making payments for debts incurred in transactions among Japanese businesses after the war when almost all Japanese had nothing but a strong desire to work. Using the notes in lieu of money, people needed no money to buy materials, commodities and services—just a small piece of paper, a bit bigger than a check, on which was written only the names of the issuer-payer and the receiver, the maturity date, the place of payment and the face amount of the debt. The place of payment is usually the branch office of bank where the issuer maintains its checking accounts. One
of the most important businesses of Japanese commercial banks is
the discounting of promissory notes from their customers and most
of a bank's profit is derived from discounting notes.

To make notes more reliable, all regional clearing houses made
their own private rules requiring that each member bank publicize
the dishonoring of notes if its customer failed to pay on its issued
notes twice during 6 months. According to the private rules, all
member banks are prohibited from extending credit to an issuer
who has been so publicized and such issuer was not able to issue
notes and checks for 2 years. Therefore, the announcement that
one had failed to pay on notes twice within 6 months was effectively
a death sentence against the issuer, by excluding him from the
commercial world. Such a declaration of one's notes being
dishonored constitutes, substantially, an adjudication of bankruptcy
in business society. Even a single failure of payment of a note has a
severe adverse impact on the issuer's financial reliability.

Once a declaration of one's notes being dishonored is made, a
receiver of promissory notes issued by such an issuer, possibly an
unsecured creditor, with a huge amount of debt owed to him from
transactions that occurred over several months prior to the declaration,
may also be affected. Should maturity dates be scheduled to be
a date 6 months after the issuing date, promissory notes and
purchase money for a designated amount, that will be
incurred over a designated term in the future through a series of
similar or identical transactions set forth in the agreement that creates
the hypothec. Ne-teitoiken or floating hypothecs are very
popular in commercial and business transactions.

III. SECURED RIGHTS IN JAPAN

1. Hypothec or "Teitoiken"

A hypothec or "teitoiken" on immovable is the king of secured
rights for the repayment of debts. After the end of World War II
and before the bust of the economic bubble in the early 1990s, the
market price for land continued to rise, and the myth which told
that the price would never fall prevailed all over Japan. Due to the
limited availability of land, as Japan consists of a group of islands,
most Japanese tend to assume that land is the most precious type of
asset, and they believed that the price of land would never decline.
Even after the prosperity bubble burst, parcels of land generally
remain expensive compared to those in other countries.

After the conclusion of an agreement to create a hypothec or tei-
toiken, it must be registered at the local registration office, where
the encumbered immovable is located, to be perfected. Usually, a
hypothec is created on a building and its site jointly or just on the
parcel of land itself only when there is no building on it. There is a
separate record kept for each parcel of land and each building. In
every registered record appear all registered property interests,
including ownership, hypothec, easement and others. Registered
records are open to the public at local registration offices and
anyone can have access to all such records and is able to request
copies of them.

There is one variety of hypothec which is called "ne-teitoiken".
Sections 390–398 of the Civil Code provide the rules for hypo-
thechs generally, whereas sections 398-2–398-20 provide the rules for
"ne-teitoiken" or a "floating hypothec". A normal hypothec or tei-
toiken is used to secure a single debt incurred by a single credit
transaction, whereas ne-teitoiken or a floating hypothec is used to
secure all potential debts, up to a designated amount, that will be
incurred over a designated term in the future through a series of
similar or identical transactions set forth in the agreement that creates
the hypothec. Ne-teitoiken or floating hypothecs are very
popular in commercial and business transactions.

2. Assignment of Accounts Receivable

A new statute regarding the perfection of assignments of ac-
counts receivable became effective in October, 1998. Before the new
statute became effective, any assignment of an account receivable
could be perfected only by notice to the account-debtor from a
creditor in which the creditor of the assigned account informs the
account-debtor, e.g. the third-party debtor, that the account was
transferred. The new law provides that the assignment of accounts
receivable can be perfected by registration at the competent local
registration office where the domicile or place of business of the
accounts-debtor is located. Perfection of a bulk assignment of all
future or of a certain type or types of future accounts receivable
can be perfected by the registration mechanism established by the
new law. Thus, the new law made perfection of bulk assignments of
future accounts receivable easier, and it is expected that it will
become much more popular than ever to assign all future receiv-
able accounts receivable to secure debts that will be incurred in the future.
proceeding is used to handle both business and consumer bankruptcies, but it is too complicated for individual consumer bankruptcy proceedings. Nowadays, more than 95% of all straight bankruptcy cases are consumers’ cases, with most of them being non-asset or nominal-assets cases. The new draft law may, therefore, try to refine consumer bankruptcy proceedings.

The court may refuse to grant a discharge in some situations according to the present law. However, the bases to deny discharge provided by the present law are vague and severe. For example, a debtor who borrowed money by deceiving his creditor regarding his credit standing may not be discharged according to § 966-9 (2) of the Bankruptcy Code. A debtor might “deceive” his new lender if he does not tell the lender that he already owes large amount of debts to other creditors, but it is impossible for other creditors to borrow money by telling a new lender of his inability to pay. Although a debtor who wasted money cannot be discharged according to §§ 366-9 (1) and 375 (1), the meaning of “wasted money” is vague. A debtor who spent money on gambling may not be discharged according to the same sections, but a debtor who lost his money at horse racing may try to recover his loss by buying another pari-mutuel ticket using money borrowed through an automatic lending machine installed near the horse race track, even though the use of such funds will be unknown to the lender. Accordingly, the new draft law may be more generous in granting discharges than the current law.

The new draft law is expected to create a new proceeding to rehabilitate an individual debtor, which may be similar to Chapter 13 of the Bankruptcy Code of the United States to some extent. An individual debtor, who pays his debts in part over a specified period pursuant to an approved plan administered by a coordinator, may be discharged from the obligation to pay the remaining debt. However, it is very controversial whether a debtor, who has a regular source of future income, is obliged to invoke the new rehabilitation proceeding before filing a petition for straight bankruptcy. Many think it is improper to allow a debtor with a source of future income to request a discharge without making partial payments—that he must first try to pay. The new German Insolvenzordnung, which compels a debtor to continue to pay for as long as seven years, may be too rigorous, whereas the U.S. system, in which a debtor with a future source of income can request a Chapter 7 discharge without trying to pay in part by a Chapter 13 plan, might be too generous.

In addition to the rapid increase in the number of petitions for bankruptcy discharge by consumer debtors, many consumer cases are settled by means of mediation in magistrates’ courts. The new bill might be drawn up with the assumption that mediation for
consumer debts may survive even after the new consumer rehabilitation proceeding is established, and that mediation will be utilized when a debtor can pay all debts fully upon extending the payment period agreement with creditors.

2. New Reorganization Proceeding

The Corporate Reorganization Act will continue in force for reorganizing huge business corporations, including listed companies in the securities markets, banks, and security companies, even after the creation of the New Insolvency Law. Amendments to the Corporate Reorganization Act, adding special provisions to be applied to the reorganization of banks and security companies, were made in 1997 and 1998. These provisions are designed to protect bank depositors and security companies' customers.

The new Insolvency Law will establish a new reorganization proceeding, thereby repealing the current composition and corporate arrangement proceedings.

Among other things, two main defects in the Composition and one main defect in the Corporate Arrangement have long been recognized. First, commencement of a composition proceeding does not stay secured creditors from realizing their secured assets, and secured rights cannot be changed by a composition plan. In other words, secured creditors are free from natural persons. The proceeding. Business rehabilitation cannot be achieved without adjusting secured rights because crucial facilities are encumbered by the secured rights. Another problem is the lack of retention of jurisdiction by the court after its confirmation of a composition plan. It is generally recognized that one of the reasons why the installment payments promised in a plan may not be made in many cases is the lack of supervision by courts over debtors on an ongoing basis; debtors might be lazy without the courts' supervision.

In a Corporate Arrangement, in contrast to a Composition, realization of secured rights may be stayed by the courts' order, but the arrangement plan cannot bind any creditor who does not consent to the plan. Thus, only consensual plans are available in Corporate Arrangement proceedings. It is unanimously recognized that there is no means to compel a stubborn creditor into making a concession.

The Questionnaire suggests that a New Reorganization Proceeding, outlined as follows, may be established by the New Insolvency Law.

The New Reorganization Proceeding will be invoked to reorganize all sorts of entities, including business corporations regardless of their size, non-profit organizations, and natural persons. The New Reorganization Proceeding consolidates the current Composi-
be performed by both sides as of commencement of the case if performance according to the contract by the trustee is not favorable for the estate.

The trustee collects and sells the assets belonging to the estate, pays administrative expenses and distributes the remaining proceeds among the creditors according to the priority schedule provided for by the Bankruptcy Code. Taxes, salaries and wages are of high priority. Distributions must be made on a pro rata basis among creditors in the same class.

Secured creditors are not stayed and can enforce their secured rights as if the bankruptcy proceeding were not under way. If a secured creditor fails to complete the enforcement of its secured rights prior to the deadline designated by the court at the request of the trustee, the trustee may sell the secured property free and clear of the secured rights. A secured creditor who has not been fully satisfied on his credit is entitled to receive a payment for the uncollected deficit at the level of a general unsecured creditor after the completion of enforcement of his secured right provided he files the remaining deficit claim, attaching ample proof, before the final distribution starts.

Non-asset cases and nominal asset cases, in which assets are not sufficient even to pay administration expenses, are terminated at the time of adjudication without appointing a trustee. Most consumer cases are terminated simultaneously with the bankruptcy adjudication to be followed only by discharge proceedings.

The court grants a discharge to a party only once every ten years. Upon a motion by the bankrupt and after notice to creditors and a hearing, a discharge is granted unless the bankrupt committed bankruptcy crimes, obtained assets by defrauding creditors with regard to the bankrupt’s financial condition within a year before the adjudication, filed a false claim or made a false representation to the court regarding the bankrupt’s financial affairs, or did not perform its duties provided for by the Bankruptcy Code. The following acts constitute bankruptcy crimes: destruction, concealment and transfer of assets belonging to the estate with the intent to hinder creditors; loss of significant assets and/or incurring excessive debt because of gambling and/or extravagance; transfer of assets with actual intent to defraud creditors; destruction, falsification or concealment of accounting books; or intentional failure to keep accounting books.

As credit-cards are very widely used and consumer loans are quite popular in Japan now, petitions for consumer bankruptcy are increasing in number tremendously since the early 1980s. More than 95% of all petitions for bankruptcy were made by individuals and more than 70,000 petitions were made for bankruptcy by
VI. SPECIAL LIQUIDATION OR "TOKUBETSU-SEISAN"

Another proceeding that may be invoked for liquidation is the "Special Liquidation" or "Tokubetsu-Seisan" under the Commercial Code. Upon a petition made by a liquidator elected at a shareholders' meeting, along with the passing of a resolution to wind up the corporation in distress, the court orders the opening of a special liquidation proceeding when the requirements for it, including but not limited to insolvency, are met. The court may replace the liquidator for cause. The liquidator administers the proceeding under the supervision of the court. The liquidation plan, which is proposed by the liquidator, must be accepted at a creditors' meeting by a majority of three-fourths in amount and more than one-half in number of creditors present at the meeting. The court then approves the plan. Only "Kabushiki-gaisha", which is an entity composed of stockholders with limited liability, is eligible for the special liquidation proceeding. Very few publicly held corporations invoke the special liquidation proceedings, because notice for the stockholders' meeting whose agenda is to wind up the debtor-corporation must be made to all shareholders at least 2 weeks prior to the meeting. When such notice is made publicly, creditors may come to know the financial crisis of the debtor-company, then they may rush to engage in collection efforts and the debtor's assets might be dissipated accordingly. Therefore, in practice, only closely held corporations avail themselves of the special liquidation proceeding.

VII. COMPOSITION OR "WAGI"

There are two statutory composition proceedings in Japan. One is to prevent a potential bankruptcy from commencing at an early stage of difficulty, and the other is to terminate a pending bankruptcy proceeding.

1. Preventive Composition or "Wagi"

Preventive composition (hereinafter referred as "composition") under the Composition Act is useful not only for rehabilitation but also for liquidation. Every type of entity, including natural persons, business corporations and non-profit organizations, is eligible for composition. Composition is the most popular proceeding to rehabilitate business corporations of a regular size. Upon the filing of a petition by a debtor, the court may issue a provisional stay order, which enjoins the debtor from payment of any debts and disposing of any assets without prior court permission.

The examiner appointed by the court investigates the debtor's affairs and the feasibility of the plan filed by the debtor with the petition to open the case. If the court finds that the plan may be feasible and is in the interest of the creditors by reference to the examiner's report, and also finds that the other requirements for such a proceeding are met, then the court orders the opening of the case.

Upon the commencement of the case, any individual collection efforts by unsecured creditors are stayed automatically without any further order for injunctive relief. However, secured creditors are not stayed and cannot be prohibited from enforcing their secured rights in the course of the composition. Furthermore, secured creditors are not affected by a composition plan.

A composition trustee is appointed by the court at the time the case is opened, while the examiner is appointed at an early stage of the proceedings, after the filing of a petition. The debtor remains in possession of its assets, but prior consent of the trustee is required to conduct activities outside the ordinary course of business. The trustee can prevent any act by the debtor, even when the act is within the ordinary course of the debtor's business. The debtor is under the triple supervision of the trustee, the examiner and the court while the case is pending.

Unsecured creditors vote for the proposed plan at the meeting of creditors. Once the notice of the creditors' meeting is made, the debtor may change the plan only to the benefit of the creditors. The plan must be accepted at the meeting by a majority of three-fourths in amount and more than one-half in number of creditors present at the meeting. When a filed claim is contested, the court determines only the amount of the voting rights for the contested creditor. The court approves the accepted plan when it finds the other requirements for a plan, including equal treatment among the same class of creditors, are met.

If no appeal from the confirmation order is filed within a week following the confirmation, then the case is closed and the court does not retain its jurisdiction afterwards.

2. Composition to Terminate Bankruptcy or "Kyosei-Wagi"

Another composition proceeding is the composition to terminate a pending bankruptcy proceeding under §§ 290—346 of the Bankruptcy Code. Only an adjudicated bankrupt is eligible to use this composition for termination. The procedure for the composition to
terminate a pending bankruptcy is similar to that of the preventive composition, except with regard to the continuation of the debtor’s possession and the appointment of a composition-trustee and an examiner. Instead, the bankruptcy trustee who is appointed for the pending bankruptcy case keeps his position until the closing of the case, even after the composition plan is filed.

VIII. CORPORATE ARRANGEMENT OR “KAISHA-SEIRI”

Only a company with limited liability, a “kaishisha-gaisha”, is eligible to use a corporate arrangement proceeding. Upon the filing of a petition by a director, a creditor, or a shareholder holding a certain value of claims or stock, the court may issue a provisional stay order which enjoins the debtor from paying any debts and from disposing of any assets without prior court permission. The court may appoint an inspector or supervisor to investigate the corporation debtor and other related matters. After completing the investigation and if the court finds the requirements for this proceeding, including reasonable prospect of rehabilitation, to have been met, the court will order the opening of the corporate arrangement case. Upon the commencement of the case, unsecured creditors are automatically stayed from making any kind of collection efforts.

The court may appoint a supervisor, collaborator, administrator or inspector at its discretion. The officers of the corporate debtor remain in their positions unless an administrator is appointed. The administrator, who is appointed only in exceptional cases, is vested with all powers of the corporation’s chief executive officer, officers and board of directors. It can do anything, subject to obtaining court approval for certain designated matters, other than those matters which only a shareholders’ meeting can decide.

Usually, a plan will be filed by the debtor within six months following the opening of the case. The court designates the deadline for filing the plan and may extend it for cause. Most plans provide for partial reductions in the amount of, and extensions to the time to pay, debts in the same way as a composition, and provide for payment plans of as long as five, six or seven years. The reduction percentage ranges between 50% and 90% usually. The debtor solicits the creditors to accept the proposed plan. When almost all creditors agree to the plan, then the court orders the consummation of the plan. The debtor pays the installments according to the terms provided for by the agreed plan under the supervision of the court. When almost all payments provided in the plan have been made, the court closes the case.

Dissenting creditors are not affected by the plan. However, they cannot collect their debt in reality, because the debtor is prohibited from paying any debt not in accordance with the plan. Creditors are also prevented from invoking any execution proceeding, including attachment, while the case is pending.

Although realization upon or enforcement of secured rights is not stayed even after the commencement of the case, the court may suspend the attempt to enforce a secured right for a certain period in order to help the debtor to negotiate with the secured creditor. Repeated renewals of the suspension order may be helpful for the debtor.

IX. CORPORATE REORGANIZATION OR “KAISHA-KOSEI”

Despite the fact that the Corporate Reorganization Act was enacted with reference to Chapter X of the former U.S. Bankruptcy Code of 1898, as amended by the Chandler Act of 1938, the practice of reorganization in Japan is quite different from that of the United States because of different customs and traditions in both countries.

Only a “kaishisha-gaisha” or company with limited liability is eligible for corporate reorganization like a corporate arrangement proceeding. Immediately after the filing of a petition by a debtor in difficulty, the court appoints an interim administrator with or without an examiner. Additionally, a creditor or shareholder who holds a certain value of claims or shares may file the petition voluntarily.

After the investigation made by the administrator or the examiner has been completed, the court orders commencement of the case if the requirements for the proceeding, including reasonable prospect of reorganization, are met. An administrator or joint administrators are appointed by the court at the time the proceeding is ordered. The administrator takes possession of the debtor’s entire estate, thereby assuming control, and is entitled to operate the debtor’s business. Officers and directors of the debtor are deprived of possession of its assets and of the power to operate its business.

Upon the commencement of a case, all creditors, without exception, including secured creditors and revenue authorities, are automatically stayed from taking any acts to collect their debts, including execution, attachments, and realization or enforcement of secured rights.

The administrator can avoid preferential and fraudulent conveyances to recover thus transferred assets and can reject unfavorable executory contracts similarly to his powers in a straight bankruptcy or “hashin” proceeding, as mentioned above. In Japan, in contrast to the United States, a collective bargaining agreement is not considered an executory contract which can be rejected.
Appraisal of all assets is made based on the going concern value, with some exceptions. The court sets the deadline to file claims with the court's clerk. All creditors, regardless of whether they are secured, must file their claims to be paid. Otherwise they lose their claims and are expelled from the case administration. Secured status is determined based on going concern value of the property in which the secured creditor has an interest. The holder of any claims that are objected to must sue the trustee in order for the contested claim to be allowed.

The administrator must file a plan within a certain period as designated by the court. The deadline to file a plan may be up to one year after the commencement of the case, provided that an extension of such period may be granted for cause. A creditor and the debtor are also entitled to file plans. The plan must be feasible, fair and equitable, must provide for equal treatment of claims of the same class, and must be in the best interests of all parties in interest. Usually a proposed plan provides for a partial reduction and extension of time to pay debts. In many cases the duration of installment payments ranges from five to seven years, and the percentage reduction ranges from 50 to 70% for unsecured claims. Secured claims are paid in full over longer periods than unsecured claims in installments but without interest.

Japanese case law has adopted a relative priority rule in applying the fair and equitable requirement instead of an absolute priority rule. However, shareholders are deprived of their interests in the debtor corporation without any compensation because liabilities considerably exceed assets in almost all cases. A typical reorganization plan in Japan wipes out all existing stock and issues new stock. A plan may provide for the establishment of a new company, merger and/or consolidation with others, transfer of all assets to others or other appropriate means to reorganize the debtor. A plan may also provide for the orderly liquidation of the debtor that chooses not to pursue further the reconstruction of its business.

At a creditors’ meeting the proposed plan is accepted or rejected by a vote. Creditors and shareholders are divided into classes comprised of parties with substantially the same interests. In most Japanese cases, all unsecured creditors constitute one class, and secured creditors are not usually divided into so many classes, unlike the general practice in the United States. A plan is accepted by unsecured creditors when the creditors with two-thirds of all allowed claims in amount consent. To be accepted, a plan which provides only for extensions of the time for payment of secured claims must be approved by the secured creditors' classes, with the required majority being three-quarters. If the plan has provisions which impair secured claims by means of a partial reduction, a ma-

X. INTERNATIONAL ASPECTS OF JAPANESE INSOLVENCY LAWS

1. Relevant Provisions in Statutes

Japanese insolvency statutes are based on strict territoriality. The legislative history of the Bankruptcy Code of 1922 reflects the concept that, for islands such as Japan, it makes sense to provide that, in order to facilitate expedient administration, any assets located in overseas countries do not constitute a part of the estate. In 1922, it took as long as a few months to go to Europe. Nowadays, however, we can communicate all over the world by telephone and fax in a moment. Besides, we can go anywhere on the earth within 24 hours. Therefore, leading commentators try to construe narrowly the meaning of the provisions based on strict territoriality. Such legal opinions influence insolvency practice. Relevant provisions in Japanese insolvency statutes are as follows:

Section 2 of the Bankruptcy Code:

A foreigner or foreign corporation shall have the same status as a Japanese national or Japanese corporation in regard to bankruptcy. This will apply, however, only when a Japanese national or Japanese corporation enjoys the same status under the domestic laws of the foreigner or the foreign corporation in question.

Section 3 of the Corporate Reorganization Act:

A foreigner or foreign company shall have the same status as a Japanese national or Japanese company in regard to corporate reorganization proceeding.
Section 3 of the Bankruptcy Code:

A bankruptcy adjudged in Japan shall be effective only with respect to the bankrupt's properties located in Japan. A bankruptcy adjudged in a foreign country shall not be effective with respect to the bankrupt's properties located in Japan. Obligations enforceable by way of judicial proceedings under the Code of Civil Procedure shall be deemed to exist in Japan.

Section 4 of the Corporate Reorganization Act:

Reorganization proceedings commenced in Japan shall be effective only with respect to the company's properties in Japan. Reorganization proceedings commenced in a foreign country shall not be effective with respect to properties in Japan. Obligations enforceable in judicial proceedings under the Code of Civil Procedure shall be deemed to exist in Japan.

Section 197 of the Bankruptcy Code:

Where there has been a prior adjudication of bankruptcy in a foreign country, the petitioner for bankruptcy in Japan need not give prima facie proof of the facts comprising causes of the bankruptcy.

Section 11 of the Composition Act:

Articles 2, 3, . . . of the Bankruptcy Code shall apply mutatis mutandis to a composition proceeding . . .

2. Power of Japanese Trustees in Foreign Countries

A Japanese trustee of a bankrupt debtor or a reorganized corporation is able to take possession and dispose of the debtor's assets located in foreign countries despite the provisions of Section 3 of the Bankruptcy Code and Section 4 of the Corporate Reorganization Act. These sections provide that Japanese courts cannot extend their jurisdiction directly over debtors' assets located in foreign countries, but do not deprive Japanese trustees of their power to take control of debtors' assets in foreign jurisdictions. Rather, a Japanese trustee is required to make every effort to bring back all assets, including assets located abroad, which constitute the debtor's estate, and to make them available for liquidation or rehabilitation purposes. Professor Taniguchi wrote in his article:

"Bankruptcy proceedings . . . have been considered as distinctly in rem: the proceeding is directed against certain property, namely a bankrupt estate. In exercising its in rem jurisdiction, a court is geographically limited within its jurisdictional territory . . . As long as the bankruptcy court's powers are strictly limited to its in rem jurisdiction, the logical result would be strict territoriality, which would lead to unsatisfactory conclusions . . . Thus it is clear that greater power should be delegated to the bankruptcy court and the administrator under it. One solution would be to recognize not only the court's in rem jurisdic-


2. Tokyo High Court, Shion 23 (ra) 728, Jan. 12, 1959 (10 Kaminshu I; 160 Honshu 50).

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preliminary injunction in an order dated March 11, 1986 which stayed all activities to collect debts owed by Sanko, including commencement of any judicial or other proceedings. Objections to the petition were filed by Chase Manhattan, Citibank and other creditors. However, after the court approved the stipulations made between the administrators of Sanko and the objectors, all objections were withdrawn. The Court then issued a permanent injunction which enjoined all collection efforts, including commencement of any judicial or other proceedings against Sanko and the enforcement of liens. Grounds for the objections included that the Japanese Corporate Reorganization Act does not provide the adequate protection for relief from stay equivalent to Sections 361 and 362 of the Bankruptcy Code and that the Japanese reorganization proceeding is not so informative as Chapter 11 in the United States. The stipulations limited the scope of the injunction to acts that may be taken within the United States against Sanko or property of Sanko which is located in the United States.3

The trustee or the administrator of a debtor for whom an insolvency proceeding is pending under Japanese law may be also eligible to file for a parallel and full proceeding with the U.S. Bankruptcy Court of competent jurisdiction under Section 305(b)(4).

3. Creditor’s Rights in Overseas Countries to Collect Debt Owed by the Debtor for Whom Japanese Insolvency Proceeding is Pending

As a consequence of a Japanese court being unable to exercise its jurisdictional power beyond the border of Japan, a Japanese court is not able to enjoin a foreign creditor or a Japanese creditor from collecting on its claim by levying on the debtor’s property located in overseas countries through foreign judicial proceedings. Also, a foreign foreclosure proceeding is not stayed to stop realization upon a secured right attached to the debtor’s property located in the foreign country.

In one case, a Japanese shipping company failed and underwent a corporate reorganization while its ships continued in service abroad. When one of the ships entered the Canadian port of Hamilton, a Japanese secured creditor attached it through the Canadian judicial process. The administrator in the reorganization objected and argued that such attachment was not permitted under Japanese law. After extended litigation in Montreal, the Canadian Federal Court upheld the validity of the attachment. The court held that:

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**“This Section 4 of the Corporate Reorganization Act repeals verbatim Section 3 of the Bankruptcy Code enacted in 1978. No one in Japan, familiar with the law, has ever doubted that the Japanese legislature intended in 1952 to make the new Corporate Reorganization Act subject to the same territorial principle as the Bankruptcy Code already in force. And the legal doctrine in Japan is unanimous as to consequences that derive from such a position. No one, so far, has ever publicly disputed the principle that where bankruptcy or corporate reorganization proceedings have been commenced in Japan with regard to a Japanese debtor, his creditors, whether Japanese or not, are permitted by virtue of Section 3 of the Bankruptcy Code or Section 4 of the Corporate Reorganization Act, to take any steps or to institute any actions or legal proceedings before a foreign Court against property situated outside Japan. And no one, so far, has ever publicly disputed that creditors holding mortgages on properties a debtor, either bankrupt or being reorganized, which situated outside Japan are permitted to foreclose their mortgages and assert their rights before the foreign Court having jurisdiction. In the sole judicial decision that has dealt with either of the two sections, a decision dealing with Section 3 of the Bankruptcy Code, the traditional opinion was clearly upheld . . . My duty is to apply this case, the law of Japan as it is today, and in order to ascertain what that law is, in the absence of any direct court precedent, I cannot adopt an approach that would lead me to go beyond the plain meaning of the statutory language and to give a provision of the law an interpretation contradicting a view unanimously held, up to this day, by all of the practitioners, commentators and scholars of Japan. As I already said, it is not for a Canadian Court to initiate a completely new interpretation of Japanese statutes, however regrettable its effects might suddenly appear when read in its natural and traditional sense. In my opinion, the law now stands in Japan, the commencement of corporate reorganization proceedings against the owners does not preclude the plaintiff from foreclosing its mortgage and asserting its rights against the defendant ship while she is lying in a Canadian port, some of the events of default agreed upon in the deed of mortgage having undoubtedly occurred. The action was not brought in violation of any Japanese law or of any judicial orders made thereunder, since the right it was meant to assert and enforce was a valid one under the laws of Japan. . . . In bringing the action in this Court the plaintiff was not 'forum shopping' nor was it abusing the process of the Court, since there was no other forum where its right could be so asserted and enforced. This Court, having undoubtedly jurisdiction to entertain an action in rem based on the foreclosure of a mortgage against a ship lying in Canadian territory, has no alternative but to recognize the plaintiff's right and give effect to its claim.”**

It is hard to find any objection in the Japanese legal community to the proposition that an unsecured creditor who has collected a

part of its claim from the debtor’s assets located in an overseas country is to be barred from receiving further payment on the claim until equally entitled creditors receive payment through a Japanese insolvency proceeding of equivalent value to the creditor’s partial recovery in the foreign country. However, a disparity would exist if the creditor who has collected on its claim in a foreign jurisdiction must return the amount recovered abroad to a Japanese trustee or other creditors in Japan. Professor Takeshita stated that:

“By virtue of Subsection 1 of Section 3 of the Bankruptcy Code and Subsection 1 of Section 4 of the Corporate Reorganization Act, judicial proceedings, including enforcement and attachment against the debtor’s assets located in foreign countries to recover claims made after the commencement of bankruptcy and reorganization proceedings in Japan, are not illegal in any sense. Also, a secured creditor is not prohibited from asserting its secured rights against the debtor’s assets located in foreign countries. Therefore, a creditor who recovered from foreign assets is not compelled to return the recovered amount to a trustee or an administrator in Japan. However, the creditor’s recovery abroad is credited against any dividend payable in Japan.”

Professor Taniguchi is of a different opinion, stating that:

“Although an adjudication of bankruptcy does not directly address creditors, they are automatically enjoined from collecting their debt individually. They must file claims with the court in order to obtain a dividend from the estate. This effect comes from the Japanese bankruptcy court’s jurisdiction over the creditors. However, not all creditors are subject to this jurisdiction. First, Japanese creditors, whether or not they have a claim with the court, are deemed to be subject to it in personam jurisdiction and are thereby prevented from acting in derogation of the proceeding. Where the Japanese proceeding is a corporate reorganization, Japanese secured creditors are thus automatically enjoined from attaching foreign property. It is possible, however, that a foreign authority, recognizing this prohibitory effect under Japanese law, might allow a Japanese creditor to recover a debt in that country through a legal proceeding. Such a recovery would constitute unjust enrichment under Japanese law and would have to be returned to the administrator. If the foreign legal proceeding is itself an insolvency proceeding, the recovery should be credited against the creditor’s recovery in the Japanese proceeding. Second, foreign creditors, normally unaffected by Japanese law, are nevertheless subject to the effects of in personam control if they have voluntarily submitted themselves to Japanese insolvency proceeding. In addition, by doing business or having a domicile in Japan, foreign creditors may automatically submit themselves to insolvency proceedings in Japan.”

6. Taniguchi, Supra note (1).

In Japan, which is basically a civil law country, the legal concept of jurisdiction in rem or personal is not familiar. Thus, Professor Takeshita’s opinion is likely to be more persuasive than that of Professor Taniguchi. No judgment has been rendered on this problem so far.

4. Effects of a Foreign Insolvency Proceeding and Powers of a Foreign Representative in Japan

A foreign insolvency proceeding has no effect in Japan according to Subsection 2 of Section 3 of the Bankruptcy Code and Section 4 of the Corporate Reorganization Act. In one case, an Indian bank brought a civil lawsuit in Japan requesting the payment of its bank loan by an Indian debtor who had been declared bankrupt in Hong Kong. The defendant alleged that the plaintiff was not able to file a complaint in Japan on the grounds that any action to collect a debt from the bankrupt is stayed under the bankruptcy laws of Hong Kong. The Osaka District Court concluded that the bankrupt Indian may be sued in Japan. The court held that a bankruptcy adjudicated in a foreign country shall have no effect in Japan.

However, Japanese courts do not deny the power of a foreign trustee to represent a foreign debtor in Japan for whom an insolvency proceeding has been commenced in a foreign country. The Tokyo District Court ordered pre-judgment attachment based on a petition filed by a Japanese creditor against a registered trademark owned by a Swiss corporation which had been adjudicated bankrupt in Switzerland. Upon a motion made by the Swiss trustee of the bankrupt corporation asking for the cancellation of the provisional attachment order, and upon depositing a certain amount of money, Tokyo District Court cancelled the pre-judgment attachment order. If the amount of money specified in the pre-judgment attachment order has been deposited, the court must cancel the attachment under the provision of Section 22 of the Civil Provisional Order Act. The attachment creditor appealed, alleging that a foreign trustee is not eligible to sue in Japan according to the provisions of Subsection 2 of Section 3 of the Bankruptcy Code. The decree to cancel the attachment order was affirmed. The Tokyo High Court held that a foreign trustee is entitled to bringing any action in Japan on behalf of a bankrupt with regard to property located in Japan.

In another case, a shareholder, who held stock representing 50%
of all outstanding issued shares in a Japanese corporation, was declared bankrupt in Norway on May 12, 1989, and a trustee was appointed at the same time. The Japanese corporation, knowing of the commencement of the bankruptcy proceeding in Norway, held a shareholders' meeting on June 30, 1989 to elect new directors, thereby wiping out the former Norwegian directors without any notice to the Norwegian shareholder's trustee. The Norwegian trustee sued the Japanese corporation to rescind the resolution of the shareholders' meeting electing new directors, on the grounds that no notice to convene the meeting was given. The Tokyo District Court rescinded the resolution in favor of the plaintiff, holding that the foreign trustee in bankruptcy duly appointed by a foreign court with competent jurisdiction is entitled to represent the foreign bankrupt in Japan over the objection of the defendant.9

Professor Taniguchi stated that:

"Subsection 2 of Section 3 of the Bankruptcy Code provides that a bankruptcy adjudicated in a foreign country shall not be effective with respect to the bankrupt's assets located in Japan. Foreign trustees or administrators can do nothing with regard to the bankrupt's assets located in Japan in literal meaning of the words contained in this provision. What the provision denies, however, is only the universality, meaning that no foreign adjudication is effective all over the world at all. In other words, this provision does not prohibit a foreign trustee from taking possession or disposing of the bankrupt's assets located in Japan. The meaning is that a debtor can be adjudicated bankrupt in Japan after being adjudicated so in foreign countries, permitting a creditor to collect his claim, seizing debtor's assets situated in Japan even after the commencement of insolvency proceedings in foreign countries but before the adjudication in Japan."10

Professor Takeshita said in his article that:

"Japanese creditors may collect their claims, seizing the debtors' assets situated in Japan even after the commencement of insolvency proceedings in foreign countries according to Subsection 2 of Section 3 of the Bankruptcy Code and Section 4 of the Corporate Reorganization Act. However, foreign trustees and administrators may take debtors' assets under their control and dispose of them, despite these provisions."11

5. Advice to Foreign Representatives
A foreign trustee and/or an administrator is able to take control