



**ISSUES ARISING IN THE CROSS-BORDER INSOLVENCY
OF GROUPS OF COMPANIES IN JAPAN**

by Shinjiro Takagi

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CORPORATE AFFAIRS DIVISION, DIRECTORATE FOR FINANCIAL AND ENTERPRISE
AFFAIRS
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
2 RUE ANDRÉ-PASCAL, PARIS 75116, FRANCE
[HTTP://WWW.OECD.ORG/DAF/CORPORATE-AFFAIRS/](http://www.oecd.org/DAF/corporate-affairs/)

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1) The Law of Recognition and Assistance for Foreign Insolvency Proceedings

In 2000, Japan enacted the Law of Recognition and Assistance for Foreign Insolvency Proceedings (LRAFIP) which adopted almost all the provisions of the UNCITRAL Model Law on Cross-Border Insolvency, and abolished the notorious territorialism contained in Japanese insolvency laws for so many years. Since the LRAFIP became effective in 2002, only two cases have been filed (one by a foreign trustee and the other by a debtor in possession), calling for recognition and assistance under the LRAFIP.

The former case was Jinro, a big Korean distiller, that filed a corporate reorganisation case in Seoul. The latter was Azabu Building, a Japanese real estate company, that filed Chapter 11 in Honolulu. Both cases were filed for the purpose of preserving their assets located in Japan. The Tokyo District Court issued its decision to recognise and assist the foreign proceedings. Jinro had several subsidiaries but, so far, no complications have arisen with respect to the corporate group problem in inbound cases.

As for an outbound case, in 1991, before the enactment of the LRAFIP, soon after the filing of a petition by the trustee of Maruko (a reorganising company under the Corporate Reorganisation Law pending in the Tokyo District Court), a parallel Chapter 11 proceeding was commenced in the Bankruptcy Court of the Central District of California. Both cases proceeded simultaneously. The reorganisation plans were filed, accepted and confirmed in Tokyo and Los Angeles in almost the same week. Both plans were substantially similar in respect of the impairment of debts and equities. Maruko's subsidiary located in Australia owed trade debts to Australian contractors for ongoing projects of resort condominiums at that time. After negotiation with the contractors, the Japanese trustee paid the debts at the

settled amounts to the contractors in order to sell the development project, and both the Tokyo District Court and the Bankruptcy Court for C.D. California approved the transaction.

2) Workout for international corporate group cases handled by the Industrial Revitalisation Corporation of Japan

The Industrial Revitalisation Corporation of Japan (IRCJ), which is a government-backed asset management corporation with a limited life, has assisted 41 business corporation groups between May 2003 and March 2005. The IRCJ has purchased debts owed by distressed companies to financial institutions. The IRCJ has restructured the purchased debts by means of partial debt forgiveness and/or debt equity swaps through out-of-court workout together with financial institutions. In some cases, the IRCJ has also infused new money into the assisted companies as capital. The IRCJ has helped large corporate groups such as Kanebo and Daiei.

The IRCJ also helped Mitsui Mining, which was a corporate group. The parent Mitsui owed significant amounts of debt to a foreign bank. After repeated and intensive discussions, the foreign bank consented to the proposed debt restructuring plan.

Fortunately, only a few complex cross-border issues have arisen in the out-of-court workout reorganisation of large corporate group cases so far. However, difficulties may emerge in the near future as Japanese corporations resume their overseas investment in parallel with the economic recovery.

The Kanebo case

The Kanebo groups has engaged in several businesses including cosmetics, food, medicine, natural and chemical textiles, appliances and others. The group consisted of 55 domestic subsidiaries and 8 affiliated companies. In addition to these subsidiaries, there were 30 subsidiaries and affiliated companies in Brazil, China, France, Germany, Indonesia, Italy, Mexico, the UK, and the US.

The IRCJ helped to restructure debt owed to about 100 financial creditors by 35 domestic Kanebo companies, including the parent company, out of 59 domestic affiliated companies. Regarding the remaining 24 affiliated companies, there was no need to help because they were solvent or debts owed to creditors outside the Kanebo group were immaterial. As for the 35 companies helped by the IRCJ, the debts were so complexly tied up

that it was not realistic to single them out. There were downstream, upstream and cross-guarantees between group companies. There were also inter-group debts. The brand name of Kanebo was well-established for more than a century in Japan and also widely recognised overseas. Management of the parent company controlled subsidiaries directly or indirectly.

After the public announcement of the IRCJ's assistance to Kanebo, the parent company guaranteed all debts owed by subsidiaries to external creditors, subject to the condition that all financial creditors whose debts were to be impaired by the proposed debt restructuring plan consent to the plan. After intensive negotiations, unanimous consent to the plan was obtained. Partial debt forgiveness on a prorated basis, and other debt restructuring were consummated according to the plan.

Except for selected viable cosmetics wholesalers that could continue their businesses in Europe and the US, most foreign subsidiaries were sold or closed because they were mostly engaged in non-core businesses with no synergies with the intended core business after debt restructuring.

When the number of shares was enough to control the subsidiaries, they were sold to buyers by auction. If the affiliated company was a joint venture with a foreign partner, the stock owned by Kanebo was sold to the partner at a price settled by negotiation based on a valuation made by professional advisers.

Fortunately, most foreign subsidiaries and their affiliated companies were solvent and able to pay their debts in full. Although a few affiliated companies located in China were insolvent, the parent Kanebo had to pay the affiliated companies' debts in full and supply additional money before leaving the country for fear that liquidation costs might exceed the unpaid debts. For these reasons, there was no need to file insolvency or out-of-court workout proceeding in foreign countries.

The Daiei case

Daiei was a giant retailers operating more than 250 general merchandise stores, supermarkets and discount stores. The IRCJ helped 12 companies out of 115 affiliated companies which belonged to the Daiei group. The group companies owed debts to more than 100 financial institutions which were not related to the group. The IRCJ helped only subsidiaries with excessive debts owed to unrelated creditors and controlled by Daiei. The parent Daiei also guaranteed the subsidiaries' debts and restructured these debts in a similar manner to Kanebo. Daiei had two subsidiaries in the US and three subsidiaries in China. These foreign subsidiaries were solvent and there was no need to help. Daiei sold these foreign subsidiaries according to the

accepted reorganisation plan that had been drafted with the assistance of the IRCJ, and paid their debts in full using the money received from the sale of the companies.

3) Consolidated statutory corporate reorganisation proceedings

Both the Japanese Corporate Reorganisation Law and the Civil Rehabilitation Law provide for procedural consolidation when the administration of reorganising companies is practical and reasonable. Neither law, however, provides for the substantial consolidation that is provided by the US Bankruptcy Code.

Usually, both the Tokyo and Osaka district courts consolidate the reorganisation proceedings for corporate group companies. These courts used to appoint trustees for subsidiaries at the recommendation or consent of the trustee of the parent reorganising corporation so that reorganisation proceedings of the group companies could be dealt with in a harmonised way and reorganisation plans of group companies could be drafted simultaneously to avoid any possible contradiction and observe and duly refer to the fair, equal and equitable rule, which is the basic principle common to insolvency laws.

The reorganisation proceedings regarding group companies are administered in a collaborative manner by a team of trustees who are closely related to each other, and all the proceedings are developed simultaneously or at a harmonised pace.