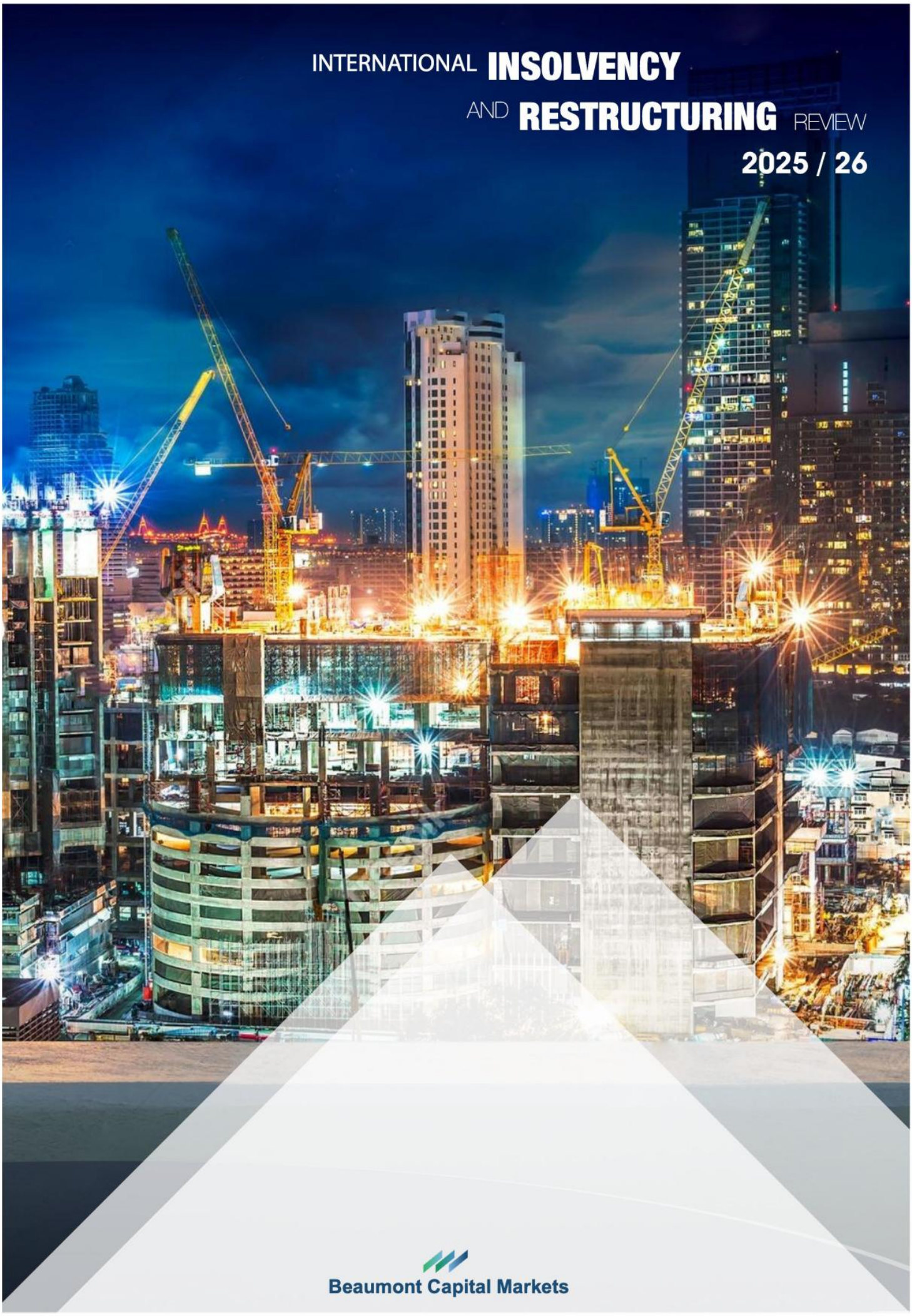
INTERNATIONAL INSOLVENCY AND RESTRUCTURING REVIEW 2025 / 26



Beaumont Capital Markets

JAPAN

NAVIGATING JAPAN'S EVOLVING INSOLVENCY LANDSCAPE: A REVIEW OF LEGAL AND MARKET DEVELOPMENTS

MORI HAMADA & MATSUMOTO

Ryo Kawabata
Partner

ryo.kawabata@mhm-global.com

+81-3-6266-8945

www.mhm-global.com

BIO

Ryo Kawabata is a partner at Mori Hamada & Matsumoto who is admitted in Japan and New York and has extensive experience in leading representations of debtors, secured and unsecured creditors, bondholders, private equity funds, acquirers of assets, hedge funds and other institutions acquiring controlling positions in financially distressed companies in in-court insolvency cases and out-of-court restructurings both in Japan and internationally. Ryo's engagements have ranged across a wide array of industries, including retail, telecommunication, chemical, pharmaceutical, textile, energy, oil and gas, automotive, apparel, manufacturing, project finance and shipping. With his leading role in the Marelli case, out-of-court corporate workout (Turnaround ADR) and subsequent in-court insolvency proceedings of a leading auto parts suppliers with approximately 160 subsidiaries in more than 20 countries, he was recognised as 'Innovative Practitioner' at the Financial Times Innovative Lawyers Asia-Pacific Awards 2023.

MORI HAMADA

MORI HAMADA & MATSUMOTO

Takashi Harada
Associate

takashi.harada@mhm-global.com

+81-3-6266-8512

www.mhm-global.com

BIO

Takashi Harada is a senior associate at Mori Hamada & Matsumoto (Singapore) LLP. He works primarily in the practice areas of restructuring and insolvency, tax and M&A. In relation to restructuring and insolvency practice, he provides comprehensive advice on legal and tax matters for financially distressed companies, particularly those overseas. He actively addresses the latest legal and tax issues, including those related to cryptocurrencies, NFTs, and digital nomads. He also conducted research on double taxation adjustment for dividends and taxation on capital gains and losses from transfers of shares in Europe, the United States and Asia as part of a research project commissioned by the Ministry of Finance of Japan, submitting a report that summarised the results of his research in April 2021.

MORI HAMADA

MORI HAMADA & MATSUMOTO

Yuichiro Ishida
Associate

yuichiro.ishida@mhm-global.com

+81-3-5223-7755

www.mhm-global.com

BIO

Yuichiro Ishida is an associate at Mori Hamada & Matsumoto. He has mainly handled restructuring and insolvency, dispute, labor law, M&A and general corporate matters. In the field of restructuring and insolvency, he has extensive experience in out-of-court workouts and in-court insolvency proceedings, including both large and small cases on behalf of debtors and creditors. He also has experience in representing foreign companies in litigation. Since 2021, he has served as an advisory lecturer at The University of Tokyo School of Law, teaching civil and criminal law to students without prior legal education or experience.

MORI HAMADA

NAVIGATING JAPAN'S EVOLVING INSOLVENCY LANDSCAPE: A REVIEW OF LEGAL AND MARKET DEVELOPMENTS

I. LEGAL SYSTEM OVERVIEW

i. Introduction

Japan has two categories of in-court insolvency proceedings:

a. restructuring-type insolvency proceedings, which are processes for restructuring the debtor's business without extinguishing its juridical personality, based on a restructuring plan that includes changes to the rights of creditors; and

b. liquidation-type insolvency proceedings where all of the debtor's assets are liquidated and, if it is a legal entity, the entity itself is extinguished upon completion of the proceedings.

We have four types of in-court insolvency proceedings. Civil rehabilitation proceedings (*minji-saisei*) and corporate reorganisation proceedings (*kaisha-kosei*) fall within restructuring-type insolvency proceedings, whereas liquidation-type insolvency proceedings consist of bankruptcy proceedings *(hasan*) and special liquidation (*tokubetsu-seisan*).

Out-of-court workouts are becoming more commonly used to restructure financial debts without starting the above-mentioned in-court insolvency proceedings, which usually damage the debtor's going concern value.

ii. Main features of each type of in-court insolvency proceedings

Civil rehabilitation proceedings

Civil rehabilitation proceedings, governed by the Civil Rehabilitation Act, are the most common form of in-court, restructuring-type insolvency proceedings in Japan, and these proceedings can be used for any type of company.

MORI HAMADA

In general, civil rehabilitation proceedings are a DIP (debtor-in-possession) process: the debtor's management team remains in control of the debtor and its assets throughout the process unless there are exceptional circumstances that lead to the taking of control from management. Having said that, this does not mean said management's control is completely unaffected by the commencement of civil rehabilitation proceedings. Courts may and usually do require the debtor to obtain their prior permission before it engages in certain types of activities, typical examples of which include disposal of property and accepting the transfer of property that is out of the ordinary course of the debtor's business, borrowing money, filing an action, settling a dispute and waiving a legal right. In addition, courts usually appoint a supervisor who monitors the debtor's activities throughout the process and gives consent to the debtor to engage in the above-mentioned permission-required activities on behalf of the court.

In terms of how voting for the restructuring plan works, there is only one class that can vote consisting of holders of rehabilitation claims, which are, roughly speaking, claims that existed before the commencement of the proceedings. The rehabilitation plan must be approved by:

a. a simple majority in number of rehabilitation claims holders voting at the meeting (or in writing); and
b. a simple majority by value of all rehabilitation claims, the holders of which have voting rights.

Under the standard schedule of the Tokyo District Court, the entire process of civil rehabilitation proceedings takes approximately five months; however, the actual length may vary depending on the complexity and circumstances of each case.

A shorter form of civil rehabilitation proceedings known as simplified rehabilitation proceedings (SRP), wherein debtors can skip the process of examining and determining creditors' claims, can usually be concluded within one to two months with the consent of 60% or more of the creditors who have filed claims.

Corporate reorganisation proceedings

Corporate reorganisation proceedings, another form of in-court, restructuring-type insolvency proceedings governed by the Corporate Reorganization Act, have a similar process to civil rehabilitation proceedings; however, there are some key differences, such as:

a. corporate reorganisation proceedings are available only for stock corporations – various other corporate forms, such as unlimited partnerships, limited partnerships and LLCs cannot use these proceedings;
b. a trustee takes possession of and control over the debtor's business and assets; and
c. secured creditors cannot exercise their security interests outside the proceedings.

Corporate reorganisation proceedings are mainly used in complex cases with large debts. Although the trustee, who is appointed by the court with the exclusive right and authority to manage the debtor's business and to administer and dispose of the debtor's assets throughout the process, is usually an attorney who has expertise in insolvency cases (administrative-type corporate reorganisation), there have been some cases in which the court appoints trustees from the debtor's current management (DIP-type corporate reorganisation).

Bankruptcy proceedings

Bankruptcy proceedings, governed by the Bankruptcy Act, are the most commonly used form of liquidation for insolvent companies. Broadly speaking, the main purpose of bankruptcy proceedings is to liquidate the debtor's assets (including sales of its businesses) into cash to be distributed equitably to creditors. Upon commencement of bankruptcy proceedings, a trustee is appointed by the court and takes possession of and control over the debtor's property, unless the debtor does not have enough assets to fund the expenses of the process (in which case, the bankruptcy procedure is closed immediately with the juridical personality of the corporate debtor being diminished).

Special liquidation

Special liquidation, governed by the Companies Act, is a form of liquidation that is only available to stock corporations that have been placed into a voluntary liquidation process by their shareholders. It is a simpler, less onerous and more expeditious form of liquidation than bankruptcy, which is frequently used by parent companies to liquidate loss-making subsidiaries.

“

Corporate reorganisation proceedings are mainly used in complex cases with large debts.

iii. Out-of-court corporate workouts

In Japan, out-of-court corporate workouts generally refers to processes where debtors facing financial difficulties attempt to negotiate with financial creditors on amending their existing debts. Out-of-court corporate workouts cause less deterioration of the debtor's business value mainly because processes are private in principle and trade creditors such as suppliers and vendors are not involved in the process and are kept intact. For this reason, out-of-court workouts are becoming more commonly used to restructure debtors' businesses.

“

In Japan, out-of-court corporate workouts generally refers to processes where debtors facing financial difficulties attempt to negotiate with financial creditors on amending their existing debts.

One unique aspect of Japanese out-of-court corporate workouts is that in addition to purely consensual, ad hoc negotiations with financial creditors, there are a variety of processes or guidelines for workouts, which are chosen based on the circumstances such as the amount of financial debts, the number of the creditors to be involved and the size of the debtor.

Among the variety of schemes, Turnaround ADR, one of the standardized forms of corporate workouts, is the most popularly used in recent years, especially for large companies. Turnaround ADR is a process in which the debtor tries to restructure its debts owed to financial creditors based on their unanimous consent. Although the success rate of Turnaround ADR is generally high and debtors in many cases successfully restructure their debts without shifting to in-court insolvency proceedings, there are cases where the debtor cannot obtain unanimous consent for its restructuring plan. In such cases, the debtor must consider initiating in-court insolvency proceedings.

Recently, the Industrial Competitiveness Enhancement Act (ICEA) provides specific measures that facilitate a smooth transition from Turnaround ADR to SRP. By using these measures provided by the ICEA, the restructuring plan proposed in Turnaround ADR may be approved by a majority vote (not unanimous consent) and carried out in SRP much more smoothly and quickly than in ordinary in-court insolvency cases.

II. RECENT AND FUTURE MARKET OVERVIEW

In Japan, the number of in-court insolvency cases and large out-of-court workouts is increasing due to the ongoing impact of the commencement of full-scale repayment of 'zero-zero loans' (interest-free and unsecured loans formerly granted by financial institutions as a special governmental rescue package for companies affected by the COVID-19 pandemic). Recent statistics[1] indicate that there were 9,901 in-court insolvency cases[2] in 2024, an increase for the third consecutive year and the highest number since 2014. Global factors, such as the shortage of semiconductors, have also contributed to the increased number of in-court insolvency cases, including the civil rehabilitation proceedings of Nihon Denkai, a listed company that has struggled with total debt of approximately 14.8 billion yen.

1. For more information, please refer to 'Japan's Business Failures in 2024', published on the Teikoku Databank's website (https://www.tdb.co.jp/report/bankruptcy/aggregation/3krjfg3s0uf/).
2. Out of the 9,901 in-court insolvency proceedings in 2024, 266 were civil rehabilitation proceedings, 12 were corporate reorganisation proceedings, 9,271 were bankruptcy proceedings, and 352 were special liquidations.

III. RECENT AND FUTURE LEGAL DEVELOPMENTS

i. Introduction of a new regime enabling debtors to cram down creditors without using in-court insolvency proceedings

Due to the COVID-19 pandemic, total corporate debt in Japan has increased from 567.9 trillion yen in December 2019 to 699.7 trillion yen in June 2024. It is reported however, that businesses are hesitant to commence the existing restructuring regimes to reduce their excessive debt, emphasising the necessity for a new restructuring regime that:

a. does not disrupt current business and transactions,
b. can be executed swiftly, and
c. is accessible before the company becomes insolvent.

The existing regimes do not cater to these needs. In-court insolvency proceedings are made public and involve all types of creditors, including trade creditors. They may negatively result in credit concerns and affect ongoing transactions, whereas out-of-court workouts require the consent of all financial creditors involved in these proceedings, which may present time obstacles to smooth business restructurings and ultimately lead to in-court insolvency proceedings.

Given these circumstances, the Subcommittee on Business Restructuring was established by the Ministry of Economy, Trade and Industry (METI) in June 2024 and published a draft report in December to propose new proceedings where financial creditors are bound by a majority vote. Their major features are as follows:

a. These proceedings can be utilised by businesses that are 'at risk of falling into financial distress' as a preliminary stage to the 'financially distressed' state under the Civil Rehabilitation Act.
b. These proceedings are supervised by a third-party institution designated by METI, which possesses specialised knowledge and practical experience in restructurings.
c. The claims subject to these proceedings are limited to those held by financial institutions.
d. For secured claims, only the unsecured portion of the claim is subject to modification under these proceedings.
e. At any creditors' meetings consisting of a single class, a restructuring plan can be passed with the approval of at least three-quarters of the total voting rights of the voting creditors. If a single creditor holds at least three-quarters of the total claim amount of the voting creditors, the consent of the majority of the voting creditors present at the meeting as a headcount is also required.
f. After the creditors' resolution, the court will review and approve the restructuring plan, focusing only on particularly critical points such as the fairness of the proceedings. Exceptionally, if the consent of all creditors is obtained, the court's approval is not required.
g. Debtors may choose which proceedings to use—these new proceedings or existing ones including Turnaround ADR.

“

Due to the COVID-19 pandemic, total corporate debt in Japan has increased from 567.9 trillion yen in December 2019 to 699.7 trillion yen in June 2024.

Given the high possibility that this new regime, once introduced, will change the landscape of out-of-court corporate workouts, insolvency practitioners should continue to keep a close eye on public comments on the draft report and how it will ultimately be legislated.

ii. Introduction of comprehensive collateral system

Japanese laws have not had any type of security interests that cover the entire businesses of debtors comprehensively. Without any measures to securitise certain types of intangible assets such as know-how and customer bases, tangible assets such as real estate, inventory and equipment have been most commonly used as collateral. Traditionally, it has been common for the debtor company's management to provide personal guarantees for lenders. However, such lending practices have been criticised for leading to results such as:

a. not actively financing companies, including start-ups, that do not have valuable tangible assets; and
b. discouraging corporate management from turning around the fundamental business because they are reluctant to use their own assets to repay company debts.

A bill was promulgated in June 2024 to include the introduction of a brand-new type of security interest called 'corporate value security interest', which allows lenders to secure any and all properties of a debtor—existing or future, tangible or intangible, registrable or not—as a security interest. Also, in response to the criticism against traditional lending practices based on personal guarantees provided by management for debtors, the law includes a provision that prohibits creditors that have corporate value security interests for their debts with debtors from enforcing personal guarantees provided by members of management for those debtors, except in limited cases, such as when management is engaged in fraudulent activities.

These mechanisms will come into effect within a period not exceeding two years and six months after the date of promulgation. They are expected to prompt the management of financially distressed companies to make early decisions on drastic business turnarounds.

“

Japanese laws have not had any type of security interests that cover the entire businesses of debtors comprehensively.

Value.
Growth.
Impact.

With integrity and resilient efforts,
we create value for clients,
provide a place of growth
for our professionals,
and have a positive impact
on our community.

MORI HAMADA

Tokyo | Osaka | Nagoya | Fukuoka | Takamatsu | Sapporo | Yokohama | Kochi
New York | San Francisco Bay Area | Beijing | Shanghai | Singapore
Bangkok (Chandler Mori Hamada Limited) | Yangon (Myanmar Legal Mori Hamada Limited) | Ho Chi Minh City | Hanoi
Jakarta (ATD Law in association with Mori Hamada) | Manila (Tayag Ngochua & Chu, a member firm of Mori Hamada)

Practice Areas

M&A
Corporate Law
Capital Markets
Structured Finance / Banking
Asset Management / Funds
Energy / Infrastructure
Real Estate / REITs
Financial Regulation
Dispute Resolution
Restructuring
Crisis Management / Compliance
Labor & Employment
Competition / Antitrust
Intellectual Property
TMT (Technology, Media & Telecom)
Tax
Wealth Management
Life Science / Healthcare
Consumer Law
International Trade
Sustainability / Environmental Law
Public Policy

Latest Topics

We are delighted to share with you our new branding and website, reflecting our evolution as a leading Asian law firm. And we have launched a foreign law joint enterprise, marking a significant milestone in our journey towards international growth and collaboration.

Our new brand does not change our commitment to excellence in all areas of law and our dedication to our clients' success. We are grateful for the trust and support of our clients and colleagues around the world, and we look forward to collaborating with you and building new relationships in the future.

Mori Hamada & Matsumoto
16th Floor, Marunouchi Park Building, 2-6-1 Marunouchi, Chiyoda-ku, Tokyo 100-8222, Japan
E-mail: info@morihamada.com / www.morihamada.com Public Relations Partner: Kenichi Sekiguchi (Daini Tokyo Bar Association)