



7. Overview of Bankruptcy Proceedings in Japan and the Impact of COVID-19

Although Japan has so far been successful in keeping COVID-19 cases relatively low, the economy has been heavily hit by the COVID-19 pandemic and the government's request for self-restraint. The number of bankruptcy cases in Japan has been increasing due to such economic impact and unfortunately, the number is expected to continue to grow in various industries. This Newsletter provides an outline of general bankruptcy proceedings in Japan and the impact of COVID-19 on bankruptcy practice.

Overview of Bankruptcy Proceedings in Japan

If a company goes bankrupt or revives its business, the company must first decide whether to undertake a court procedure or an out-of-court procedure. An out-of-court procedure is advantageous in the sense of flexibility, but to undertake an out-of-court procedure, the company needs to obtain the consent of all creditors during the procedure.

Bankruptcy proceedings involving the court are roughly divided into two types of proceedings, i.e., liquidation and reconstruction. Liquidation proceedings can be further subdivided into bankruptcy proceedings based on the Bankruptcy Act and the Special Liquidation Proceedings based on the Companies Act. On the other hand, rehabilitation proceedings can be further subdivided into Rehabilitation Proceedings based on the Civil Rehabilitation Act and Reorganization Proceedings based on the Corporate Reorganization Act.

Bankruptcy Proceedings under the Bankruptcy Act

The following is a summary of the bankruptcy proceedings under the Bankruptcy Act (the mechanism described below is basically common to other procedures, but the trustees are appointed only in bankruptcy proceedings.):

1) Petition for Commencement of Bankruptcy Proceedings.

Creditors, debtors, and directors may file a petition for

commencement of bankruptcy proceedings. Most petitions are filed by debtors. To file a petition, a deposit must be paid to the court. The amount of deposit is calculated based on the amount of debt and can be relatively expensive compared to other countries. For example, a company with a debt of JPY 100 million or more but less than JPY 500 million will need to pay a JPY 2 million deposit to file a petition.¹

Once the petition is filed, the court may order a stay of the procedure already initiated against the debtor's property for compulsory execution, provisional seizure, provisional disposition, etc.

2) Commencement of Bankruptcy Proceedings

When the bankruptcy court issues an order of commencement of bankruptcy proceedings, one or more bankruptcy trustee(s) will be appointed at the same time with the issuance of the order. Although there is no requirement as to qualification of the bankruptcy trustee(s) under the Bankruptcy Act, bankruptcy trustees appointed are almost exclusively attorneys-at-law in Japan. The right to administer and dispose of the bankrupt company's property will be vested to the bankruptcy trustee, and the bankrupt company will lose such right. Bankruptcy claims cannot be enforced without going through the bankruptcy proceeding. Bankruptcy trustees conduct realization of properties that belongs to the bankruptcy estate. When the bankruptcy trustees have finished realization of the bankruptcy property and has secured the resource to distribute to the bankruptcy creditors, the bankruptcy trustees will implement the

¹ http://www.ginzaseiwa.jp/feature/feature05_01.pdf

liquidating distribution. In typical case, it will take from a few months to a year from the initiation of the bankruptcy procedure to the distribution. The distribution rate can vary significantly depending on the case, but the average distribution rate is zero to five percent of the original claim amount in case of bankruptcy procedure. In rehabilitation proceedings, the average distribution rate was 15.3% based on the 2017 data, but there were cases where the distribution rate was 100% and cases where it fell below 1%. These numbers show significant variation of distribution rate in rehabilitation proceedings depending on the case.²

3) Participation in Proceedings by Bankruptcy Creditor

Once the petition is filed by a debtor, bankruptcy creditors cannot take any individual measures. The creditors' only recourse is to participate in the bankruptcy proceedings controlled by the court. To participate in the proceedings, a creditor needs to file a bankruptcy claim together with proof of claim, such as contract documents, etc., within a defined period. The bankruptcy trustee shall decide to approve or disapprove each bankruptcy claim after investigation of the bankruptcy claims. As stated above, if the bankruptcy trustee can secure the resource for distribution, the bankruptcy creditors will receive distribution in proportion to the amount of bankruptcy claims. In addition, one or more creditors' meeting is held by the court to report the status of the debtor's property. The creditors are not obliged to attend such creditors' meeting. A creditor's non-attendance will have no negative impact.

The Impact of COVID-19 on Bankruptcy Proceedings

1) The impact of declaration of a state of emergency³ and Request for Self-Restraint in response to the COVID-19 in Japan

In Japan, the declaration of a state of emergency (hereinafter referred to as "the Declaration") was implemented nationwide in response to the spread of COVID-19 on April 7, 2020. Based on the Declaration in multiple prefectures including Tokyo and Osaka, the governors of each prefecture issued requests for self-

restraint. In particular, the governor asked companies to close their businesses and individual citizens to refrain from going out on for about one month and a half. Although courts were not completely shut down, the state of emergency has significantly slowed down court procedures including the bankruptcy procedures.

2) Economic Measures in Response to COVID-19

Since the outbreak of COVID-19, governments across the world have enacted new laws relating to countermeasures against the deterioration of economic conditions due to COVID-19. Bills relating to the same subject are also being discussed. Some of such new laws include changes relating to bankruptcy procedures. For example, in the United States, under the CARES Act which was enacted in response to COVID-19 crisis, a temporary amendment was made regarding the raising of the maximum amount of debt, etc., which is a requirement for the Small Business Reorganization Act. Under the CARES Act, more small businesses are now able to rebuild. In the United Kingdom, a petition for liquidation of a company was temporarily disallowed. In Germany, the debtor's statutory obligation to file for insolvency and the creditor's right to request the opening of insolvency proceedings was temporarily suspended until the end of September.

On the other hand, in Japan, no special laws have been enacted in relation to bankruptcy proceedings so far. However, various economic measures have been implemented to avoid small business operators to go bankrupt. For example, the Financial Services Agency ("FSA") and other organizations have requested financial institutions to support the financing of small business operators in response to the issuance of the Declaration. Also, due to the enactment or enforcement of the Act on Temporary Special Provisions of the Local Tax Act for Pandemic Novel Coronavirus Diseases and New Infectious Diseases Preparedness and Response (Act No. 25 of 2020),⁴ taxpayers whose income have been reduced by more than 20% due to the effects of COVID-19 are granted 1 year special extension on payment of their national tax in Japan.

3) Increase in Bankruptcy Cases

The number of corporate bankruptcy cases in April 2020

² <https://www.tdb.co.jp/report/watching/press/p181206.html>

³ Formerly called as "Declaration of a State of Emergency in response to the Novel Coronavirus Disease". Article 32, Paragraph 1 of the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness

and Response (Act No. 31 of 2012).

https://japan.kantei.go.jp/ongoingtopics/_00020.html

⁴ https://www.tkc.jp/consolidate/tkc_express/2020/05/202005_00333v

in Japan (debt amount of 10 million yen or more) was 743 (up by 15.1% year-on-year),⁵ and the number of COVID-19-related bankruptcy cases as of May 29 was 192.^{6,7} The number of bankruptcy cases due to the impact of COVID-19 is gradually increasing. However, in response to requests from the FSA and other organizations, it seems that financial institutions have voluntarily adjusted repayment dates and made efforts to prevent companies from becoming unable to pay debts. As a result, an increase in the number of bankruptcy cases has been prevented to some extent so far.

Most of COVID-19-related bankruptcy cases so far are that impact of COVID-19 made debtor whose business environment and the business world environment had been already deteriorated decided to file for bankruptcy proceedings, and COVID-19 was not the main cause but was a trigger of the bankruptcy.⁸ However, in the future, companies that had strong business performance before the spread of COVID-19 are expected to go bankrupt mainly due to the deterioration of business performance caused by COVID-19.

Additionally, by May 27, the top industry categories of COVID-19-related bankruptcy cases filed by companies were mainly those such as hotels/inns, restaurants, apparel and general merchandise retail stores.⁹ These are industries which have been directly affected by the decrease in movement, eating out and shopping due to the spread of COVID-19, including Renown who is a major apparel company listed in the market. The impact of COVID-19 is expected to spread to a wide range of industries such as transportation and manufacturing in the future, and chain reaction bankruptcies in other industries is not farfetched

Operational Issues related to Bankruptcy Proceedings under the State of Emergency

The impact of the Declaration has affected the operation of bankruptcy proceedings as well. For example, creditors' meetings had been postponed indefinitely because gathering in one place by several people is highly

discouraged.¹⁰ As a result, the entire bankruptcy proceedings have been delayed. In addition, bankruptcy trustee's operations especially the realization of property that belongs to the bankruptcy estate (real estate, inventory assets, etc.) has been suspended. Furthermore, as most of the documents to be submitted including proofs of claims are required to be submitted in paper and electronic filing via email, etc. is not permitted in bankruptcy proceedings, the investigation of bankruptcy claims by bankruptcy trustees have been also delayed.

A similar problem has occurred in litigation proceedings. The parties and/or counsel are required to attend court hearings physically, and hearings by video conference or telephone conference has been allowed only in exceptional circumstances. Additionally, all briefs and exhibits must be submitted in paper. In response to the Declaration, the Tokyo District Court canceled hearings, except for urgent proceedings such as provisional seizure proceedings. It also postponed the submission of briefs if the parties so requested. Although the efforts for the introduction of information technology ("IT") in litigation proceedings such as conducting hearings online using online applications (e.g., Microsoft Teams) and allowing online submission of briefs and exhibits to the court, have been made for some time, the movement towards greater use of IT should be accelerated as a result of the suspension of the entire court proceedings caused by COVID-19.

Similarly, considering the impact of COVID-19 on bankruptcy proceedings as discussed above, it is high time to increase the use of IT in bankruptcy proceedings.

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⁵ <https://www.tsr-net.co.jp/news/status/monthly/202004.html>

⁶ <https://www.tdb.co.jp/tosan/covid19/index.html>

⁷ https://www.tsr-net.co.jp/news/analysis/20200529_03.html

⁸ <https://diamond.jp/articles/-/232617>

⁹ The same as reference 5

¹⁰ <https://www.courts.go.jp/tokyo/vc-files/tokyo/2020/020408korona-kijitu.pdf>