



ASIA-PACIFIC RESTRUCTURING REVIEW 2024

The Asia-Pacific Restructuring Review 2024 contains insight and thought leadership from 10 pre-eminent Asian figures. Across 65 pages, their articles comprise an invaluable retrospective on the year just gone. All contributors are vetted for their standing and knowledge before being invited to take part. Together, they capture and interpret the most substantial legal and practice-related developments of the year just gone, complete with footnotes, relevant charts and statistics.

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Edited by Look Chan Ho

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Business turnaround following the covid-19 pandemic in Japan

[Hajime Ueno](#), [Masaru Shibahara](#) and [Kotaro Fuji](#)

[Nishimura & Asahi](#)

In summary

This article introduces and summarises the current economic circumstances following the covid-19 pandemic in Japan, explains measures relating to business turnaround and provides a brief outlook on anticipated post-covid-19 business restructuring.

Discussion points

- Overview of the current situation in Japan (2021 to 2023)
- Outlook on restructuring and insolvency following the pandemic

Referenced in this article

- SME Vitalisation Council
- Guidelines for business turnaround of SMEs
- Guidelines for debt workouts of company managers' guarantee obligations
- Turnaround ADR
- Special conciliation



Following the covid-19 pandemic

Since late 2021, Japan has gradually been easing restrictions on behaviour and border measures necessitated by the covid-19 pandemic. On 8 May 2023, Japan downgraded the severity of the virus to Class 5, which is the same level as seasonal influenza. As a result, all restrictions and other preventive measures on travel, movement, face masks, etc, came to an end. Currently, all foreign tourists are permitted to enter Japan without any covid-19-related restrictions including submitting a negative covid-19 test result or proof of vaccination. The industries heavily affected by the pandemic (such as tourism, aviation, and restaurants and hotels) are returning to pre-pandemic levels due to people's lifestyles getting back to normal and a rebound in the number of foreign tourists coming to Japan.

Overview of the state of the Japanese economy

With respect to the external environment in which the Japanese economy operates, owing to high energy prices due (at least in part) to Russia's invasion of Ukraine, the rise in labour costs and the plummeting value of the yen (the value of the yen against the US dollar has fallen by more than 20 per cent compared to five years ago), which is believed to have mostly arisen from ultra-low interest rates in Japan contrasting sharply with the higher interest rates in the United States, Japan is beginning to face a more severe economic environment.

In the past, the depreciation of the yen was generally regarded as an advantage for Japanese companies, as it allowed companies to easily enjoy a trade surplus. However, in recent years, many – if not most – Japanese companies have been shifting to overseas production and manufacturing; therefore, it is more challenging to enjoy the benefits of yen depreciation. Instead, the rise in procurement costs, which more or less correlate with import costs for many Japanese companies, has resulted in negative consequences for enterprises as a result of the yen becoming weaker. Over the past year, the prices of many commodities have risen to their highest in recent years, squeezing not only companies but also consumer household budgets.

Although Russia's invasion of Ukraine has yet to end, because Japan lacks fossil fuel resources, it must depend on imports of energy resources, or on non-carbon energy or nuclear energy for electricity power generation. However, after the Fukushima nuclear power plant accident, there is a strong sense of caution about restarting nuclear power plants. Further, as a backdrop, some power companies that emerged following the deregulation that occurred as an indirect consequence of the Fukushima accident and emerging renewable energy companies have recently been experiencing financial difficulties; some are even seeking insolvency protections as a result of certain pricing mechanisms based on market and business regulations that resulted in their



failure to recoup their initial capital expenditures through electricity sales while experiencing challenges from rising procurement and other operating costs. To date, no effective solution has been found for the energy cost issue.

In terms of monetary policy, despite the change of the governor of the Bank of Japan from Haruhiko Kuroda to Kazuo Ueda on 9 April 2023, Japan continues to implement a policy of monetary easing to support Japan's economic downturn while the United States has increased interest rates to stop inflation, so it is possible that the yen will continue to depreciate. Thus, the Japanese economy is now in a precarious situation, compounded by the uncertainties arising from the financial challenges that many enterprises and businesses are now facing or are expected to face in the course of their post-covid-19 recovery.

Insolvency and restructurings

During the covid-19 pandemic, Japan saw a decrease in the number of insolvencies and restructurings; however, as the economy has been gradually returning to normal, the tide is turning. According to Teikoku Data Bank, 2021 had the lowest level of recorded bankruptcies (6,015 cases) of any year since 1966, but the number increased to 6,376 in 2022. This trend appears to be continuing in 2023.

The decrease of bankruptcies in 2021 is believed to be, at least in part, because of government efforts to actively promote measures to aid and support ailing businesses that had been in place since the start of the pandemic. It is fair to say that those measures were somewhat successful in allowing enterprises to avoid immediate bankruptcy or insolvency, and that they prolonged the lives of impacted enterprises. This is especially notable considering that, in Japan, contrasting with other foreign countries and jurisdictions where courts were shut down for extended periods, the bankruptcy courts in Japan did not close for any significant period.

However, following the end of certain measures – including extensions on taxes and other public payments, and benefits of grants and subsidies – that were implemented in 2021, most interest-free and unsecured loans backed by government guarantee to support businesses affected by the pandemic are due in 2023. As a result, it is expected that a number of enterprises that carry more debt than they can repay are, or soon will be, facing financial difficulties.

Also, as the economy is returning to a more normal state, banks and other financial institutions appear to be more seriously considering the disposal of non-performing loans.



Outlook: once the dust settles?

One interesting aspect of the pandemic's impact on economies worldwide is that the financial markets, and equity markets in particular, have not stagnated. Rather, with most – if not all – central governments taking proactive measures to support their economies and central banks lowering interest rates to allow more funds to flow through to the economy, stock exchanges and private equity markets boomed in many countries.

This aspect of the pandemic's impact appears to be ongoing, at least in the Japanese market. With investors pouring more funds into the market, money has been more available to many enterprises, regardless of their fundamental situation. As a result, concerns have been raised that the number of zombie companies is increasing on top of the already high number of such companies that resulted from the prolonged, extremely low interest rate market and deflation that had existed in Japan for more than two decades prior to the onset of the covid-19 pandemic.

It is expected and desired that government-affiliated financial institutions, private financial institutions and private equity funds will play a significant role in supporting business operators' financial situations, and that enterprises in Japan will experience business transformations and other developments while simultaneously providing a much-needed boost to industry.

The pandemic caused immense changes to people's way of life; however, it is also possible that it merely accelerated some much-needed changes that enterprises could not push themselves to undertake before facing this unprecedented level of difficulty. During the pandemic, large and medium-sized enterprises responded to these long-awaited changes by withdrawing from unprofitable businesses and returning their focus to core businesses via selection and concentration, funding these efforts through the use of preferred stock and subordinated loans from financial institutions.

Financing to companies in industries affected by the pandemic – such as Japan Airlines (aviation), AIRDO (aviation), Solaseed Air (aviation), JTB (travel), Fujita Kanko (hotel and bridal), and TAKE and GIVE NEEDS (bridal) – has been catching the eye of market participants; these companies have been able to avoid in-court insolvency and restructuring procedures through implementing early-stage out-of-court workouts.

The enterprises struggling most in the face of the pandemic were small and medium-sized enterprises (SMEs). According to 2016 statistics, 3.57 million SMEs were operating in Japan – more than most other countries in the world. When looking at SMEs that have obtained interest-free and unsecured loans backed by government guarantees or other government support offered during the pandemic, given that the repayment of most loans will be due shortly and other government support has been lessening, SMEs for which funding is



tight are currently in need of workouts or will need to begin workouts in the near future.

However, difficulties associated with making those payments continue to arise because the business base has been affected by the pandemic or the after-effects thereof; the sales, cash and revenue flows of SMEs have not fully recovered, and it will continue to be difficult for them to come up with the funds and establish the workout plans required to finance restructuring. It may be necessary to adopt more drastic revitalisation measures rather than early-stage workouts. Measures may include severe options, such as liquidating the corporation, transferring a company's business to a sponsor, offloading any remaining debt and closing businesses. It could well be that the use of rule-based workout initiatives will present a last-ditch effort to avoid the final option of liquidation.

In Japan, the low interest rate environment and the prevalence of deflationary markets have resulted in the adoption of a number of rule-based workout initiatives. Among them are two out-of-court initiatives that can be used by SMEs:

- guidelines for business turnarounds of SMEs, which was introduced in March 2022; and
- turnaround alternative dispute resolution (ADR).

These workouts are designed to be easy to use and provide a moratorium (or stay), and both call for financial institutions to sit at the bargaining table (and government agencies have been asking that financial institutions do so). From the perspective of financial institutions, in addition to the predictability of these procedures, they are easier to accept because they contain explicit statutory grounds for non-taxed write-offs being permitted when debts are waived through them.

Turnaround programmes for SME vitalisation

In March 2022, the Ministry of Economy, Trade and Industry, in collaboration with the Financial Services Agency and the Ministry of Finance, formulated the SME Vitalisation Package to develop comprehensive support measures to improve profitability for, revitalise and allow rechallenges by SMEs suffering from increasing debt, and to continue liquidity support for SMEs. This includes:

- the continued provision of emergency loans and subordinated loans by government-affiliated financial institutions;
- the flexible operation of the deferral system of tax and social insurance premiums (including reducing delinquent taxes);
- comprehensive support for SME profitability improvement and business revitalisation by the SME Vitalisation Council;



- the expansion of the business revitalisation fund provided by government-affiliated funds; and
- the formulation of new guidelines for SME business turnaround and guidelines for debt workouts for company managers' guarantee obligations as another rules-based out-of-court workout process.

Out-of-court workouts based on guidelines for business turnaround of SMEs are procedures aimed at facilitating the smooth business rehabilitation of SMEs by granting grace periods to repay debts (mainly financial debts) and debt reductions and exemptions, etc, for SME debtors experiencing difficult business conditions, based on agreements between SMEs that are debtors and financial creditors (non-financial creditors such as bondholders or trade creditors can also be included, but that is not the anticipated norm), not through in-court insolvency proceedings (ie, bankruptcy proceedings, civil rehabilitation proceedings, corporate reorganisation proceedings or special liquidation proceedings).

In considering the availability of this procedure, SMEs will select candidates to be third-party support experts (ie, lawyers and certified public accountants who have obtained qualified accreditations) and notify major creditors that they are considering an out-of-court workout based on guidelines for business turnaround of SMEs. At the same time, SMEs will obtain consent from all major creditors, initially only for the appointment of third-party support experts. After requesting a temporary suspension of loan repayments to the target creditors, SMEs, with the support of a third-party support expert, will formulate a business revitalisation plan that must address:

- ways or measures by which to resolve substantial excess debt within five years;
- ways or measures by which to ensure ordinary income will be converted into a surplus within three years;
- the business revitalisation plan, which must result in the cash flow ratio of interest-bearing debt in the final year of the plan being 10 times or less; and
- shareholder responsibilities (but only if the debtor SME is to call for a debt reduction and exemptions), management responsibilities and a policy for liquidating warranty liabilities when guaranteed by management.

When all target creditors agree to a proposed plan and a third-party support expert confirms this in writing, a business revitalisation plan is confirmed. In addition, third-party experts and major creditors will regularly conduct monitoring in the three fiscal years following the enactment of the confirmed plan.

Interestingly, in addition to restructuring-type out-of-court workouts, these guidelines also stipulate an out-of-court workout processes for business discontinuation (discontinuance-type procedures). In the process described



above, if a third-party support expert or major creditors determine that the business is unlikely to continue, and if the debtor SME submits an application for business discontinuance, the debtor SME may draft the necessary measures such as the liquidation of assets for business discontinuance and formulate a repayment plan. In this case, the draft plan must also be economically rational for the target creditors, such as by presenting the prospect of obtaining a better recovery than the liquidation value to be distributed in the bankruptcy proceedings.

When implementing discontinuance-type procedures for SME debts and the guarantor intends to arrange warranty obligations for such debts, the guarantor must disclose assets in good faith and utilise guidelines for debt workouts of guarantee obligations of the debtor company's management in an effort to integrate the principal obligations and guarantee obligations.

Until recently, the SME Vitalisation Council, a neutral third-party organisation, had established separate procedures, supported drafting plans and organised out-of-court workout procedures. Now, however, even SMEs that are unable to formulate plan proposals required by SME Vitalisation Council procedures because of the impact of the covid-19 pandemic or other factors can select third-party support experts and proceed with business revitalisation on their own with the consent of the target creditors. It is hoped that SMEs working to improve their businesses in the post-covid-19 climate will accelerate their efforts to revitalise their businesses based on a shared understanding with financial institutions that are eligible target creditors to take steps toward sustainable growth.

Turnaround ADR

Turnaround ADR is another popular rule-based out-of-court workout procedure in which third-party experts coordinate communications between creditors, such as financial institutions, and debtors to support debtor companies' early-stage business revitalisation.

The Japanese Association of Turnaround Professionals, as a specific certified dispute resolution business operator, is responsible for conducting ADR procedures. There is no limit on the size or industry of debtor companies that can apply to use turnaround ADR. The system can be used by SMEs and larger companies, and, as it does not involve any court oversight or supervision, no cramdown is available either in class or cross-class, and unanimous consent by the relevant creditors is required.

From the preconsultation stage, a debtor contemplating using the procedure is called upon to conduct its own due diligence and develop an outline of its business revitalisation plan. The debtor's efforts are surveyed and overseen by



a third-party expert, who is also scheduled to be retained by the Association to serve as the overseeing expert.

If there is a possibility that the proposed plan will be approved, an official application will be made, a suspension notice will be sent to target creditors (mainly financial institutions) and a creditors' meeting will be convened to appoint a third-party expert as a procedural implementer who will explain an outline of the debtor's proposed business revitalisation plan to the creditors.

If any creditors disagree with the plan, it is assumed that special conciliation, as described below, will be used or a transition to in-court insolvency procedures will occur. In the case of a transition to in-court procedures, to allow for a smooth transition (which, in turn, incentivises relevant parties to do as much as possible within the ADR procedure), the following support measures, which respect the results and actions taken during the course of the turnaround ADR, have been institutionalised and codified:

- facilitation of priority payment of commercial claims in in-court procedures;
- facilitation of priority payment of bridging loans (pre-DIP finance); and
- simplified procedures relating to the expedition of special conciliation procedures, etc.

The concepts listed above were introduced statutorily, rather than just in the Japanese Association of Turnaround Professionals' rules, and under the amended Act on Strengthening Industrial Competitiveness, which came into effect in June 2021.

Further, a transition to simplified civil rehabilitation procedures will also be facilitated if more than three-fifths of the creditors whose total claims are covered agree to the plan, even if there are also opposing creditors.

However, the amendment did not function effectively enough in one recent ADR case. Media outlets reported that MARELLI Holdings obtained consent from most of its financial creditors through its turnaround ADR process, but it had to abandon the process because it was not able to obtain consent from a minority of financial institutions, and it filed a petition for a simplified civil rehabilitation procedure with the Tokyo District Court. As mentioned above, the amendment to the Act on Strengthening Industrial Competitiveness was originally aimed at promoting unanimous consent at the turnaround ADR stage by preventing minority financial creditors from holding out and effectively gaining a veto right in an unreasonable fashion, backed up by the transition to a simplified civil rehabilitation procedure. However, the *MARELLI* case apparently did not go as the amendment intended.



To avert such a scenario, an additional amendment to address the issue would be to allow a cramdown through votes by the relevant creditors, effectively allowing the majority vote to cause the proposed restructuring plan to become effective. In the New Capitalism Grand Design and Implementation Plan approved by the Cabinet of Japan in June 2022, the government clearly stipulated 'the establishment of legislation for out-of-court workouts for business restructuring' while indicating that 'in other countries, there is a system to change creditor's rights (eg, reduction of financial debts) by majority vote with the approval of the court.' Subsequently, a committee consisting of academic, restructuring and other experts, which was established in October 2022, began discussing the issues that may arise from the introduction of new legislation for out-of-court workouts. There is a possibility that additional amendments to turnaround ADR processes and other rule-based workout initiatives will be introduced to allow a cramdown in the course of the process to further facilitate the use of, and in turn the resultant business restructuring through, those rule-based workout initiatives.

Special conciliation

The process for special conciliation is governed by the Act on Special Conciliation Proceedings for Expediting Arrangement of Specified Debts. Special conciliation pertains to an adjustment or arrangement of debts to contribute to the economic rehabilitation of debtors who are likely to become unable to pay debts. It thereby aims to expedite the arrangement of interests pertaining to the debts of the debtors.

In April 2020, the Tokyo District Court launched a programme to expedite a special conciliation process within the court divisions that handle civil rehabilitation cases and corporate reorganisations when only a certain creditor or set of creditors oppose a plan presented in a prior out-of-court workout. The target companies are those whose proceedings have been converted from formal, rule-based out-of-court workouts or who have already held meetings for their financial creditors and have had property assessment reports evaluated by certified public accountants or rehabilitation plans based on those assessments.

According to article 17 of the Civil Conciliation Act, if an agreement among the parties is unlikely to be reached, the court may issue an order to resolve the case. The order has the same effect as a successful conciliation if no parties object within a certain period, and the court announces positive use of the order as necessary.

If out-of-court workouts using the rule-based procedures outlined above or special conciliation do not work (eg, owing to an inability to obtain the unanimous consent of the creditors) or if the transition from turnaround ADR to simplified civil rehabilitation does not meet the relevant requirements, conventional civil



rehabilitation procedures and corporate reorganisation procedures must be used to restructure a business, as those in-court restructuring processes are usually the only remaining choices.

Closing remarks

In the early stages of the covid-19 pandemic, people in Japan anticipated that the number of insolvencies, especially bankruptcies, would increase rapidly; however, the number of insolvencies and restructuring cases did not spike dramatically. For example, bankruptcies triggered by the pandemic reached neither the number arising from the global financial crisis stemming from the Lehman shock nor those triggered by the Tōhoku earthquake and tsunami. This is owing to quantitative easing and the cooperation of financial institutions.

However, attempts at solutions have been provided only in the context of postponements and tentative rescheduling, which merely prolong the life of struggling enterprises by delaying the problems rather than offering real resolutions; this causes a lot of groping in the dark, with no exit clearly visible.

In Japan, as in other parts of the world, the path to economic recovery will gradually become clearer. Moreover, there is probably no way around the fact that a clear divide will grow between enterprises that adapt to the new normal and those that are less successful in adapting. For example, even in industries where overall sales recover to pre-pandemic levels, there will be enterprises that are unable to return to pre-pandemic sales levels owing to their failure to adapt to the changing times; on the other hand, there will also be enterprises that gain more momentum than they had pre-pandemic.

Some economists and market participants are calling this phenomenon a 'K-shaped economic recovery', where there will be a mix of companies that perform successfully and those that do not return to pre-pandemic sales levels. Importantly, in terms of insolvencies and restructuring, as we move towards economic recovery, we anticipate a wave of accelerated restructuring, both in terms of operational restructuring and financial restructuring (to finance operational restructuring) as, more likely than not, there will be an abundance of enterprises that unfortunately will be left behind in adapting to the new normal. It appears that this trend may have already begun, as shown by the recent increase in the number of bankruptcies.

In addition to responding to post-pandemic ways of life and changes in how our societies function, changes in the business environment, such as digital transformations and responses to sustainable development goals, will be constant and will continue to grow in importance. Recent economic challenges arising from the spikes in commodity prices, energy costs, import procurement costs, labour costs and the weakened yen will all compound the importance



of, as well as the difficulties in achieving, goals. In this respect, we expect that insolvencies and restructuring will place more importance on facilitating and accelerating each enterprise's business metabolism, as well as that of the industries and the economy overall, as we move into an ever- and faster-changing business and commercial landscape.

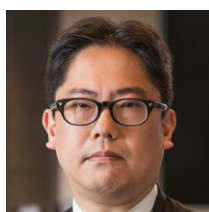
**Hajime Ueno**

Nishimura & Asahi

Hajime Ueno is a partner at Nishimura & Asahi. He has an integral role in its restructuring and insolvency practice group and is also instrumental in its corporate finance practice group, predominantly focusing on restructuring and insolvency matters and structured finance transactions, with an emphasis on cross-border cases and transactions. He has been recognised and awarded as a distinguished practitioner in the areas of restructuring and insolvency and corporate finance.

Among notable restructuring cases, he was involved as a core member in the reorganisation of Japan Airlines; the financial and operational restructuring, as well as the subsequent reorganisation, of Tokyo Electric Power Company; the financial restructuring and sale of Sharp Co, Ltd; the global restructuring of Takata group; and various restructuring cases involving low-cost carrier airlines in Japan.

Having spent part of his childhood in the United States and having graduated from Harvard Law School (2004), he is fluent in English.

**Masaru Shibahara**

Nishimura & Asahi

Masaru Shibahara is a partner at Nishimura & Asahi. He has been involved in resolving corporate legal issues and disputes. In the area of corporate finance, he handles everything from corporate acquisitions (M&A) and debt collections to general banking and finance, representing both debtors and financiers.



He is currently dealing with covid-19-related cases and matters, specifically in the food and beverage industries, and rural transportation infrastructure that is severely damaged. He is also involved in cases and matters relating to debt and equity transactions.

He has been involved in various litigation matters ranging from commercial, financial and IP disputes to corporate disputes, including managerial disputes over corporate control. In business revitalisation cases, he has dealt with not only in-court liquidation (both civil rehabilitation and corporate reorganisation) but also out-of-court workouts.

**Kotaro Fuji**

Nishimura & Asahi

Kotaro Fuji is a partner at Nishimura & Asahi. He has handled numerous corporate restructurings under formal insolvency proceedings or out-of-court workouts in Japan representing debtors, sponsors or other key parties, and recently with more focus on cross-border matters. He played a key role in the civil rehabilitation proceedings of Daiichi Chuo Kisen Kaisha and its subsidiary with over US\$1 billion in debts, which constituted the fifth largest shipping group in Japan and operated over 100 dry bulk carriers globally.

From October 2019 to February 2023, he provided legal advice on cross-border M&A, restructuring and insolvency, disputes, and other corporate matters from Nishimura & Asahi's Singapore office, collaborating with local professionals.

He is a graduate of the Kyoto University Law School (2008, JD) and the New York University School of Law (2018, LLM), and is admitted to practise in Japan (2009) and in New York (2019).



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Otemon Tower
1-1-2 Otemachi
Chiyoda-ku
Tokyo 100-8124
Japan

www.nishimura.com

[Hajime Ueno](#)

h.ueno@nishimura.com

[Masaru Shibahara](#)

m.shibahara@nishimura.com

[Kotaro Fuji](#)

k.fuji@nishimura.com
