



INSOL
INTERNATIONAL

**MSMEs - PRACTICAL
CHALLENGES AND RISK
MITIGATION POST
COVID-19**



INSOL INTERNATIONAL

International Association of Restructuring,
Insolvency & Bankruptcy Professionals

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44(0) 20 7248 3333 | Fax: +44(0) 20 7248 3384
www.insol.org

ISBN: 978-1-907764-32-5

Copyright © 2022. No part of this document may be reproduced or transmitted in any form or by any means without the prior permission of INSOL International.

The views expressed in each chapter are those of its authors and do not necessarily represent the views of the publisher or editor. The publishers and authors accept no responsibility for any loss occasioned to any person acting or refraining from acting as a result of any view expressed herein.

Copyright © INSOL INTERNATIONAL 2022.
All Rights Reserved. Registered in England and Wales, No. 0307353.
INSOL, INSOL INTERNATIONAL, INSOL Globe are trademarks of INSOL INTERNATIONAL.

Published in December 2022

President's Introduction	i
Foreword	iii
Contributors	iv
Argentina	1
Australia	12
Austria	33
Brazil	44
Bulgaria	60
Canada	74
Chile	89
Croatia	96
France	102
Germany	118
Hungary	132
India	144
Japan	157
Malaysia	174
Mexico	186
Myanmar	197
New Zealand	213
Nigeria	230
Portugal	240
Romania	258

CONTENTS

Singapore	274
South Africa	286
The Netherlands	295
Turks and Caicos Islands	303
Uganda	310
United Arab Emirates	317
United Kingdom	325
United States of America	339
Venezuela	350

CONTENTS

PRESIDENT'S INTRODUCTION

The World Bank has estimated that micro, small and medium sized enterprises (MSMEs) represent over 95% of enterprises and account for more than 60% of employment worldwide. With limitations regarding their ability to self-protect against insolvency risk, their susceptibility to systemic demand and supply shocks, their limited capital reserves and their level of debt overhang, MSMEs are in a vulnerable predicament as government fiscal and insolvency relief measures are wound back and the world endures difficult economic circumstances and tightened monetary policy measures.

This new publication from INSOL International, *MSMEs - Practical Challenges and Risk Mitigation Post Covid-19*, provides a timely overview of the informal, hybrid and formal restructuring and insolvency options available to MSMEs in the event of financial distress in 29 jurisdictions across the world. It also outlines the interim measures adopted by governments in those jurisdictions during the pandemic, and assesses the success of those measures in preserving the financial stability of MSMEs and maximising the prospect of a successful restructuring.

Each of the 29 chapters also provides an update on the latest insolvency reform measures either introduced or contemplated to provide streamlined restructuring and insolvency alternatives for MSMEs. This is especially important, with INSOL, the World Bank and UNCITRAL having identified the need for bespoke MSME processes beyond the "one size fits all" formal insolvency alternatives that are generally suited for larger enterprises.

Ultimately, given MSMEs' contribution to domestic, regional and global GDP and employment, creating flexible, efficient and cost-effective restructuring and insolvency alternatives for MSMEs is critical to ensure broader economic and financial stability, job maintenance, innovation and growth in our global economy.

Following the introduction of MSME restructuring and insolvency alternatives in the United States, Myanmar, Singapore, India and Australia in the last several years, it is hoped that similar measures will be introduced in other regions as we continue to navigate current economic conditions.

This book will provide a valuable contribution to our members worldwide, and will serve as a foundation to support ongoing law and policy reform and capacity building in coming years.

INSOL thanks each of the contributors from the 29 jurisdictions covered in this book, as well as the leader of this project, Rocky Gupta, INSOL Fellow, of UNITEDJURIS, India for committing their time, energy and expertise to ensure the completion of this book.

I hope you enjoy reading this excellent resource.



Scott Atkins

INSOL Fellow & President
INSOL International
Norton Rose Fulbright Australia

December 2022

FOREWORD

This is a special INSOL International publication which explores the insolvency frameworks and special insolvency procedures that exist for MSMEs in 29 jurisdictions worldwide. The publication also provides an overview of the interim fiscal stimulus and insolvency relief measures that were introduced during COVID-19 and the systemic challenges that MSMEs face – such as access to new money and the stigma associated with insolvency – in attempting to restructure their affairs.

Across these 29 jurisdictions, this book concentrates on the diverse tools available to facilitate the reorganisation and restructuring of MSMEs and the possible best solutions and strategies for economic distress alleviation. One of those tools, mediation, is a particular focus point and this book assesses the effectiveness of mediation as a viable restructuring tool.

For each jurisdiction, the book also includes feedback from experienced practitioners on what they see as being the best way to safeguard the interests of MSMEs and whether simplified processes exclusively for MSMEs would enhance the likelihood of a successful restructuring.

The idea of this project came in mid-2020 when the pandemic was at its peak and many businesses and companies had started getting into financial and operational distress. This was not a local phenomenon, but a global one. MSMEs, being one of the major contributors to GDP and collectively constituting almost 90% of the businesses in most jurisdictions, were facing the full impact of the pandemic.

I hope that this book will be a valuable tool for practitioners, academics and the judiciary across the world and may serve as the basis for future law reform locally, regionally and globally.

This project would not have been possible without the help and support of a team of professionals associated with this project. The initial acknowledgement must however go to the Technical Research Committee of INSOL International and Dr Sonali Abeyratne, Dr Kai Luck and Ms Waheeda Lafir in particular for all their assistance throughout the completion of the project, and of course to all the chapter contributors to the book globally for their time, expertise and commitment.



Rocky Ravinder Gupta

INSOL Fellow
UNITEDJURIS, India

December 2022

Argentina

Javier Lorente
Martin Rozental
Lorente & López Abogados

Australia

Claudine Salameh
Candy Lau
Nicole McKenzie
Josh Mackenzie
Norton Rose Fulbright Australia

Austria

MMag. Dr. Markus Fellner
Mag. Florian Henöckl
Fellner Wratzfeld & Partner
Rechtsanwälte GmbH

Brazil

Liv Machado, INSOL Fellow
Tauil & Chequer Advogados in
association with Mayer Brown LLP

Bulgaria

Hristina Kirilova
Kambourov & Partners

Canada

David Lewis
BDO Canada Limited

Chile

Diego Rodriguez-Gutierrez
Universidad San Sebastián

Croatia

Jelenko Lehki, INSOL Fellow
Lehki Law Office

France

Catherine Ottaway
Hoche Avocats
Georges Louis Harang
Addleshaw Goddard

Germany

Ivo-Meinert Willrodt, INSOL Fellow
Rasmus Linden
PLUTA Rechtsanwalts GmbH

Hungary

Dr. Ágnes Ábrahám
Lakatos, Köves and Partners Law Firm

India

Rocky Ravinder Gupta, INSOL Fellow
UNITEDJURIS

Japan

Yuri Sugano
Marie Tanaka
Kotaro Fuji
Hiroshi Kuwata
Nishimura & Asahi

Malaysia

Lee Shih

Lim Chee Wee Partnership

Matthew Ang

Ler Lum Corporate Restructuring Sdn Bhd

Mexico

Zulima González García

Pérez Correa González y Asociados, S.C.

Myanmar

Rodney Bretag

India Bennett

Stephanie Trajcevska

Norton Rose Fulbright Australia

New Zealand

Bryan Williams, INSOL Fellow

BWA Insolvency Ltd

Nigeria

Okorie Kalu, INSOL Fellow

PUNUKA Attorneys & Solicitors

Portugal

António Rocha Alves

Joana Arnaud

CS'Associados

Romania

Judge Nicoleta Mirela Năstăsie, INSOL Fellow

Bucharest Tribunal - VII Section

Singapore

David Kim

Sofia Hear

KordaMentha

South Africa

Jo-Anne Mitchell-Marais, INSOL Fellow

Deloitte

The Netherlands

Job van Hooff

Marleen Jonckers

Stibbe N.V.

Turks and Caicos Islands

Yuri Saunders, INSOL Fellow

Stanbrook Prudhoe

Uganda

Rita Baguma Birungi, INSOL Fellow

Ligomarc Advocates

United Arab Emirates

Jody Glenn Waugh

Sarah El Serafy

Al Tamimi & Company

United Kingdom

Manraj Mand

Rehan Ahmed

Cassy Bevan

Quantuma Advisory Limited

CONTRIBUTORS

MSMEs - Practical Challenges and Risk Mitigation
Post COVID-19

United States of America

Niall Ledwidge
Stout Risius Ross, LLC.

Venezuela

Roland Pettersson, INSOL Fellow
D'Empaire

JAPAN

1. Insolvency Framework - General Overview

1.1 Formal insolvency legislation

1.1.1 Overview

In Japan, there are two types of proceedings: liquidating-type insolvency proceedings (similar to United States Chapter 7), which include bankruptcy and special liquidation, and restructuring-type insolvency proceedings (similar to United States Chapter 11), which include civil rehabilitation proceedings (*minji saisei tetsuduki* or civil rehab) and corporate reorganisation proceedings (*kaisha kosei tetsuduki* or corporate reorganisation).

Special liquidation and corporate reorganisation are available only to corporations. Corporate reorganisation is designed for and used mainly by large corporations. Civil rehabilitation was originally designed as a restructuring-type procedure for MSMEs and private business operators, but today it is more often used by large or mid-sized companies above a certain size. If MSMEs consult with a specialist, they often are recommended simply to file for bankruptcy.

However, civil rehabilitation also provides special procedures for individuals (see section 1.1.2 below). Also, while it is based on practices, rather than the law, bankruptcy affords special treatment to cases of small-scale debt (see section 1.1.3 below).

1.1.2 Civil rehab procedures for individuals

In civil rehab procedures for individuals, a debtor is required to make repayments for three years (in general) based on the approved repayment plan.

There are two types of civil rehab procedures for individuals: (i) rehabilitation for individuals with small-scale debt; and (ii) rehabilitation for salaried workers.

- *Rehabilitation for individuals with small-scale debt*

This is mainly for individuals who operate small businesses. A person is eligible as an individual with small-scale debt if:

- they are likely to earn income continuously or regularly in the future; and
- the total amount of rehabilitation claims which they owe (excluding the amount of home loan claims and certain other amounts) does not exceed 50 million yen.

The minimum amount to be paid through this procedure (in general) is as follows.

Total amount of debt* (JPY)	Amount to be paid (JPY)
Up to 1 million	100% of debt
1 - 5 million	1 million
5 - 15 million	one fifth of total debt
15 - 30 million	3 million

30 million or more	One-tenth of total debt
--------------------	-------------------------

*Excluding home loan debt and certain other amounts.

- *Rehabilitation for salaried workers*

This is mainly for individuals who have regular income from their employment.

In addition to the criteria noted above, such individuals are also required to be “likely to receive a salary or earn similar regular income and the amount of the salary or income is expected to fluctuate only within a small range”.

The minimum amount to be paid through this procedure is the higher amount of either the amount calculated under the criteria noted above, or the total amount of the individual’s disposable income for a period of two years.

1.1.3 **Special treatment in bankruptcy procedures in the case of small-scale debt**

While this is based on practices, rather than the law, some courts afford special treatment to bankruptcy procedures in cases of small-scale debt.

The greatest advantage of this treatment is that the deposit amount can be lower than usual. In general, it is necessary to pay around 0.5 to 7 million JPY as a deposit to the court when filing for bankruptcy. However, if this special treatment is applied, a debtor is generally required to pay only 0.2 million JPY.

The purpose of this treatment is not only to allow a smaller deposit amount to be paid, but also to simplify and facilitate bankruptcy procedures. Therefore, this treatment is typically applied in cases of small-scale debt, cases which do not require measures in relation to bankruptcy estates (for example, a case with few or no bankruptcy estates) and cases which are expected to conclude in a short period of time. However, it is required that such cases be filed by an attorney.

The Tokyo District Court permits this treatment not only for individuals, but also for entities.

1.2 **Specific insolvency legislation**

Other than the rehabilitation for individuals with small-scale debts mentioned above, there is no specific insolvency legislation for MSMEs in Japan.

1.3 **Framework for out of court assistance or workouts**

1.3.1 **Formal framework**

- *For corporations*

- (i) Turnaround Alternative Dispute Resolution

Other than purely consensual, negotiation-based workouts, there is the Turnaround Alternative Dispute Resolution (TADR) process sponsored by the Japanese Association of Turnaround Professionals, as a formal, rule-

based, out of court workout. The TADR is the most popular process these days (especially for larger-scale debtors).

The TADR is a process through which debtors may adjust or restructure debts owed to participating creditors with the consensus of those creditors (which typically would be limited to financial creditors). Formal, rule-based, out of court restructuring processes are, in most cases, based on a statute allowing specific entities to set rules for a process offered to debtors through which a debt adjustment or restructuring can be achieved on a consensus basis with the participating creditors. They do not, however, involve any court supervision or approval of the resultant workout plan and thus are pure out of court processes.

- (ii) Workout supported by the SME Vitalisation Councils (*Chusho-kigyo Kasseika Kyogikai*), previously the SME Revitalisation Support Councils (*Chusho-kigyo Saisei Shien Kyogikai*)

The SME Vitalisation Councils provide measures to support MSMEs. Since the Councils were established in 2003, there have been more than 48,000 cases for consultations, and more than 15,000 cases for which the Councils provided and completed their support (in total).

A MSME which meets all the requirements below can apply for the Councils' support:

- suffering from business management difficulties or there is a risk of suffering from such difficulties due to financial deterioration or decline of productivity caused by excessive debts or excessive capital investment; and
- there is a possibility of business revitalisation, such as the target business being productive or having future prospects.

In addition to the requirements above, if a debtor plans to establish a business restructuring plan which includes debt waiver, the MSME is required to meet all the requirements below:

- suffering from business management difficulties mainly due to excessive debt which is difficult to resolve;
- formal insolvency proceeding may cause problems in resolving debt, as such a proceeding might lead to a decline of the debtor's credibility or otherwise have a negative material effect on its business value; and
- there is economic rationality for creditors, for example in the case where creditors may receive a repayment amount which is greater than the amount which would result from formal insolvency proceedings.

The Councils support qualified MSMEs in the following ways:

- they assist debtors with drafting business restructuring plans;

- they assist debtors with obtaining consent from their main creditors; and
- after a plan is approved, the Councils continuously monitor and provide advice on the implementation of the plan.

The Councils provide this support free of charge. However, the fees of any specialists involved in the establishment of such a business restructuring plan, such as accountants or legal advisors, should be paid by the debtor. Therefore, these measures provided by the Councils may be available only to MSMEs which possess sufficient funds.

(iii) Special conciliation

In addition, as a formal workout scheme for MSMEs, there is a special conciliation (*tokutei chotei*) process (see section 2.6 below).

- *For individual persons*

There is no formal framework specifically for individual persons.

1.3.2 Informal framework

- *For corporations*

There is no informal framework specifically for MSMEs.

- *For individual persons*

There are two sets of guidelines: one for owners or directors who provide a guarantee for a debtor company (Guidelines for Management's Guarantees), and one for individual persons who are unable to pay back their existing loans (including housing loans and business operation loans) due the effects of the Great East Japan earthquake that occurred in 2011 or other major natural disasters in Japan.

Regarding the Guidelines for Management's Guarantees, see section 3.6 below.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no specific mechanism for accelerated restructuring or liquidation of MSMEs in Japan.

1.5 Discharge of debts for natural persons

The debtor shall be discharged from all its liabilities for all bankruptcy claims when a discharge order by the court becomes final and binding (in a civil rehab case, the debtor is discharged from all its liabilities or rehabilitation claims when an order to confirm a rehabilitation plan by the court becomes final and binding), save for distribution through a bankruptcy procedure or repayment based on an approved rehabilitation plan, as well as a few other exceptions and in cases of certain tax claims.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

The loans that MSMEs struggled to repay due to the COVID-19 pandemic in Japan mainly consist of emergency loan programs provided by the Japanese Government (including local governments, such as prefectures and cities) and Government-affiliated financial institutions, in addition to various other financial subsidies provided by the Government.

In addition, although this is not specifically applicable to MSMEs, on 6 March 2020, the Financial Services Agency (FSA) requested that banks and other financial institutions respond promptly and flexibly to debtors' requests for changes to the terms of their existing debts, including deferring repayments of principal and interest. The FSA (together with the Ministry of Economy, Trade and Industry) also repeatedly requested that banks and other financial institutions provide financial support by taking into account the size of businesses.

According to a survey conducted by the FSA, there were 599,829 cases where MSMEs applied to banks for changes to the terms of their existing debts during the period from 10 March 2020 to 31 August 2021, and 99% of these applications (excluding those which are still under examination or which were withdrawn) were approved.

Although this measure does not directly extend or suspend the repayment terms of loans, the SME Vitalisation Councils provide the following measures in support of MSMEs whose sales in the last month (or in the six most recent months) have decreased by 5% or more when compared to the same period in the previous three years:

- the Councils collectively request the deferral of principal repayments to financial creditors on behalf of the debtor;
- the Councils assist the debtor in drafting a special one year restructuring plan, encourage consensus-building among financial creditors to agree to the plan, and help the debtor obtain new loans from governmental and private banks as bridge loans, if necessary; and
- after the plan is approved, the Councils continuously monitor and provide advice to the debtor on the debtor's cash flow (if the debtor so requests).

As explained in section 1.3 above, the SME Vitalisation Councils have also provided other measures in support of MSMEs, but due to the unique circumstances of the COVID-19 pandemic, several of the requirements have been relaxed (for example, the "possibility of business revitalisation" is not required).

As described above, this measure does not allow for the extension or suspension of the repayment of loans by MSMEs. However, the financial support offered by the Government and banks is believed to have contributed to preventing insolvencies, as the number of insolvencies in Japan has decreased during the COVID-19 pandemic. According to a survey by Teikoku Databank, the number of in-court insolvencies in 2020 decreased by 6.5% from 2019, and this trend has continued in the first half of 2021.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special insolvency measures or specific insolvency rules have been introduced for the simplification of proceedings for MSMEs during COVID-19 in Japan. As mentioned in section 1.6 above, the measures introduced by the Japanese Government to support MSMEs during COVID-19 were mainly taken by way of emergency loan programs and various other financial subsidies.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No measures suspending the requirement to initiate insolvency / liquidation / bankruptcy proceedings have been introduced in Japan.

2.3 Insolvency procedural deadlines

No measures extending insolvency procedural deadlines during COVID-19 for MSMEs have been introduced in Japan.

2.4 Minimum debt requirements to initiate insolvency proceedings

Japan has not introduced any minimum debt requirements for creditors to initiate insolvency procedures during COVID-19.

2.5 Suspending specific creditors' rights

No measures suspending specific creditors' rights to initiate insolvency procedures during COVID-19 have been introduced in Japan.

2.6 Mediation and / or debt counselling

2.6.1 Overview of special conciliation

As mentioned in section 1.3 above, special conciliation (*tokutei chotei*), which is governed by the Act on Special Conciliation for Expediting Arrangement of Specified Debts, is available in Japan for the rescue, restructuring or rehabilitation of MSMEs. Special conciliation is a type of mediation proceeding administered by the court or court-appointed conciliation commissioners (*chotei iin*) and is particularly aimed at adjusting monetary debts owed by financially distressed debtors (rescheduling and discharge of debts). One of the characteristics of special conciliation is an "Article 17 Order", which is based on Article 17 of the Civil Conciliation Law. Where an agreement between the parties cannot be reached, if the court finds it appropriate, it can issue a necessary Article 17 Order, which can bind all the parties to the proceedings, including those who were opposing the agreement, unless any party raises an objection to the order within two weeks.

Generally, the advantages of special conciliation are:

- as trade creditors can be excluded from the proceedings, the going concern value of the debtor deteriorates less than in the case of formal insolvency;

- since special conciliation is a proceeding based on the agreement of the parties, the content of the debtor's restructuring plan can be more flexible than in formal insolvency proceedings;
- unlike an informal out of court workout, since the court and / or court-appointed conciliation commissioners engage in the proceedings as a fair and independent third party, it is more likely that the parties will reach an agreement, including debt adjustments; and
- although in principle unanimous consent of the parties involved in the proceedings is required to reach an agreement, if any party unreasonably objects to an agreement, the court can issue an Article 17 Order.

Since the Act on Special Conciliation for Expediting Arrangement of Specified Debts came into force in 2000, special conciliation has often been used by individuals seeking to adjust financial debts. For corporate entities, including MSMEs, in some cases special conciliation was used where certain financial creditors did not agree with the debtor's restructuring plan developed in an out of court workout, but generally it has not been commonly used.

However, it should be noted that recently there have been moves to facilitate the use of special conciliation for corporate entities, especially MSMEs.

2.6.2 JFBA Guidelines

The Japan Federation of Bar Associations (JFBA), after discussions with the Supreme Court, the Ministry of Economy, Trade and Industry, and the Small and Medium Enterprises Agency, issued "Guidelines to utilise special conciliation to assist in business restructuring" (JFBA Guidelines) in December 2013 (amended in June and December 2014 and in February 2020) documenting good practices in leveraging special conciliation for restructuring of MSMEs.

Under the JFBA Guidelines, an attorney-at-law representing the debtor is supposed to take the following steps:

- examine the possibility of restructuring the debtor's business by using special conciliation;
- develop the debtor's restructuring plan including a repayment plan and debt adjustment (rescheduling and discharge of debts) by collaborating with other experts;
- hold pre-negotiations for the restructuring plan with financial creditors and ensure that the creditors informally agree on the plan;
- file a petition for special conciliation with the summary court; and
- reach a formal agreement (ratified by the court under the proceedings) between the debtor and the creditors based on the restructuring plan.

As the debtor and its attorney are supposed to obtain an informal agreement with the creditors on the restructuring plan prior to commencing special conciliation,

the court typically holds only one or two hearings, and therefore it is expected that the time and costs can be reduced compared to formal insolvency.

2.6.3 TDC New Operation

From April 2020, the Tokyo District Court launched a new operation for special conciliation (TDC New Operation) in order to achieve more rapid and cost-effective special conciliation procedures after discussions with insolvency practitioners and financial institutions. The TDC New Operation mainly covers cases where most creditors consent to a restructuring plan presented in a prior formal and rule-based out of court workout, but certain creditors do not.

Under the previous Tokyo District Court operation, the application deposit – mainly used for the fees for conciliation commissioners or investigating attorney (*chousa shokutakusaki bengoshi*), who should be insolvency experts – was a fixed amount (JPY 12 million), which is relatively expensive for MSMEs. On the other hand, under the TDC New Operation, the court decides the amount of the application deposit taking into consideration the amount of the relevant debts, the difficulty of the case, and other relevant factors on a case-by-case basis. The amount of the application deposit should be no more than that for civil rehab and reasonable (inexpensive) by limiting the matters examined by the court-appointed conciliation commissioner or investigating attorney.

In addition, under the TDC New Operation, given the debtor's restructuring plan was already examined by independent third parties in the prior formal and rule-based out of court workout, the court or the court-appointed conciliation commissioner aims to procure that the parties reach an agreement via three court hearings (this number is less than that for previous operations), which, according to the model schedule in the TDC New Operation, may take only approximately seven weeks. Also, the court has announced that it will make more active use of Article 17 Orders to facilitate a resolution between the parties.

As of April 2021, only one case appears to have been filed following the TDC New Operation, but its use is expected to increase in the future.

2.6.4 Advantages and disadvantages

It is not mandatory to initiate special conciliation prior to formal insolvency in Japan.

From a practical point of view, it may not be appropriate to make pre-insolvency special conciliation a mandatory requirement to file for formal insolvency in all cases, since some matters are not suitable for it. For example, in the case where the debtor's cash flow is very tight, immediately using the framework of formal insolvency, which has a broader and stronger effect on creditors, could be more helpful to the debtor's restructuring.

With that said, in general, considering the advantages of special conciliation described above, it is probable that the debtor, including MSMEs, can reach an agreement with financial creditors on its restructuring plan more rapidly and cost-efficiently than formal insolvency.

Also, as noted, both the JFBA Guidelines and the TDC New Operation are designed to make special conciliation less costly and less time-consuming for the efficient restructuring of entities, including MSMEs. By taking advantage of these, we believe that MSMEs can reduce the time and costs related to restructuring.

3. Challenges Faced

3.1 Stigma associated with insolvency

Although the primary purpose of formal insolvency proceedings in Japan is not to impose sanctions against insolvent debtors but to secure “rehabilitation of the business or economic life of debtors”, there is some social stigma attached to debtors including MSME promoter / entrepreneurs involved in insolvency proceedings in Japan.

In the past, especially, before the enactment of the Civil Rehabilitation Act in 2000, the insolvency proceedings in Japan were more time-consuming and cumbersome, and sometimes involved anti-social forces. Therefore, insolvency proceedings were regarded as the very last resort for debtors and filing for insolvency proceedings meant a social disgrace.

At present, there are still some social disadvantages to filing for insolvency proceedings: (i) some laws restrict bankrupts’ eligibility for certain occupations (e.g. attorney-at-law, certified public accountant, director of a financial instruments business operator) for a certain period; (ii) commencement of insolvency proceedings and the name of the debtor (if the debtor is a company, including the name of its representative) are published in the Official Gazette; and (iii) once the fact that an individual files for insolvency proceedings is registered in his / her credit information organised by credit bureaus (see section 3.2 below), the individual cannot borrow money or use credit cards for approximately five to 10 years.

Having said that, over the past few decades, key players in the field of insolvency / restructuring in Japan (including the courts and the government) have continuously made tremendous efforts to make insolvency proceedings more accessible and easier to use, especially for corporate debtors’ business restructuring and individual debtors’ fresh start, and to rid themselves of any negativity associated with insolvency proceedings, such as enacting the Civil Rehabilitation Act in 2000, introducing more flexible operation of the proceedings. We believe that, due to such efforts, the common social perception regarding insolvency proceedings has shifted from the “death” in an economic context to just one of the tools to restructure businesses or the economic life of debtors efficiently.

3.2 Availability of financial information

Credit bureaus in Japan organise the credit information of individuals based on certain data (the amount of outstanding debts, repayment history and so forth) received from its member financial institutions (including banks, non-banks and credit card companies) and other sources and provide such credit information to its member financial institutions at their request. Therefore, the financial

information of a MSME, including individual natural persons, can be easily accessed by such financial institutions.

An individual may request credit bureaus to disclose his / her registered credit information. If there are any errors in the disclosed information, the individual may request the member financial institution that provided the original data to correct the errors.

3.3 Access to new money

Under civil rehab and corporate reorganisation, it is possible for a debtor, including MSMEs, to obtain interim or new finance from a potential sponsor or other lenders either: (i) after the filing but before the commencement of the proceedings; or (ii) after the commencement of the proceedings.

In the case of (ii), the interim or new finance is automatically categorised as a “common benefit claim” (similar to administrative expenses under the United States Chapter 11 process), while in the case of (i), the court or supervisor (*kantoku iin*)’s approval is required for the finance to be categorised as a “common benefit claim”. If the finance is categorised as “common benefit claim”, it is given a priority over general unsecured claims but ranks *pari passu* with other common benefit claims under Japanese insolvency laws.

3.4 Secured creditors vis-a-vis unsecured creditors

Under corporate reorganisation, secured creditors’ rights to exercise their security interests, as well as other claims, are stayed during the proceedings while under the other proceedings including civil rehab and bankruptcy, secured claims are not stayed in principle.

Notwithstanding the types of insolvency proceedings, at the stage of repayment based on a restructuring plan or distribution, proceeds derived from collateral must be preferentially used for the repayment or distribution to the secured creditors holding the security interest on the collateral.

3.5 Insufficient asset base

A lender who provides finance to a debtor under insolvency proceedings typically requests the debtor to provide its uncollateralised assets as security. Therefore, if a debtor MSME’s asset base is low, and there is nothing to provide as security, the possibility for the debtor to obtain interim or new finance during the restructuring-type insolvency proceedings would be reduced. This could force the debtor to enter into bankruptcy.

3.6 Personal guarantees (PGs)

It is prevalent in Japan that, if a MSME is a corporate, its representative and / or other management will provide PGs to secure loans for the MSME.

In relation to the enforcement of PGs, it has been quite common that, if a MSME undergoes formal insolvency (or an out of court workout with debt haircuts), its management who provided PGs have no choice but to file for bankruptcy to deal

with the PG liabilities. This practice could be an obstacle to early restructuring of MSMEs as management usually does not wish to commence their own personal bankruptcy.

To address this problem, a study group jointly established by the Small and Medium Enterprise Agency and the FSA in January 2013 published “Guidelines for Management’s Guarantees” after discussions between MSMEs and financial institutions, together with academia and turnaround specialists, about management guarantees for SMEs in December 2013. The Guidelines aim to provide a reasonable framework for the adjustment of management guarantees, which is more favourable than that in bankruptcy, so that management can determine restructuring (or closure) of MSMEs as soon as possible. The Guidelines are not legally binding since they merely consist of rules which were voluntarily and autonomously established, but currently they are commonly used where the management of MSMEs attempts to adjust their guarantee obligations together with the MSME’s restructuring and are usually referred to and followed by the relevant parties.

According to the Guidelines, on or after a MSME (principal debtor)’s petition for formal insolvency proceedings or a formal rule-based out of court workout, the management (guarantor) of the MSME can propose to its creditors (normally financial institutions) an adjustment of the guarantee obligations pursuant to the Guidelines, for which a formal rule-based out of court workout can be utilised. In the adjustment of guarantee obligations: (i) the assets owned by the guarantor would be, in principle, realised and used to repay the creditors; and (ii) the remaining obligations would be discharged. Despite (i) above, the guarantor is permitted to continue holding a certain amount of money for living expenses and a “not gorgeous” house for living under the Guidelines (this is broader than the scope of statutory exempt properties in a bankruptcy).

3.7 Further challenges

3.7.1 Guidelines for out of court workouts for MSMEs

As many MSMEs suffering during the COVID-19 pandemic have taken advantage of emergency financing programs provided by the Japanese Government and Government-affiliated financial institutions to maintain their cash-flow, there is concern that a large number of MSMEs will become financially more vulnerable from the accumulation of excessive debts.

To tackle this issue, the Guidelines for Restructuring of Small and Medium Enterprises (*Chusho-kigyo no Jigyosaiseitou ni kansuru Guidelines*) (SME Restructuring Guidelines), prepared by representatives from financial institutions and MSMEs, experts, and academics, were published on 4 March 2022 and became effective on 15 April 2022.

As the SME Restructuring Guidelines are generally based on the previous formal, rule-based, out-of-court workout frameworks mentioned in section 1.3.1 above, the structure of the procedures and the general rules under the frameworks are similar. However, because the SME Restructuring Guidelines have been formulated particularly for MSMEs, the framework thereunder has the following specific characteristics:

- Third-party supporting experts system (utilising private sector experts such as attorneys-at-law)

Independent organisations such as the SME Vitalisation Councils and the Japanese Association of Turnaround Professionals are not involved. However, the debtor appoints “third party supporting experts” (*daisansha shien senmonka*) from the list of accredited experts, which is publicly available, with the consent of “major creditors” (*shuyou saikensha*) for the examination of whether the debtor’s proposed restructuring plan is reasonable from a fair and neutral standpoint.

- Relatively flexible substantive requirements for restructuring plans

Some substantive requirements for restructuring plans under the SME Restructuring Guidelines are more generous than those in the TADR, and several requirements can be construed flexibly depending on the debtor’s actual circumstances based on the SME Restructuring Guidelines.

- Subsidies for expert costs

In the case where an out-of-court workout based on the SME Restructuring Guidelines is carried out, provided that certain requirements are satisfied, it is possible to apply to the Small and Medium Enterprises Agency (*Chusho-kigyo Cho*) for subsidies to cover two-thirds of the costs of outside experts and third-party supporting experts (up to JPY 7 million).

3.7.2 Attempt to reform collateral law system

Traditionally in Japan, real property has been the most common form of collateral provided for loans in practice. However, to provide more flexible options for financing, recently there has been growing recognition that assets other than real property should be more readily available to be used as collateral. In this regard, although collateral over movables and claims have also been used in practice in Japan, the rules for these types of collateral have been formed mainly by court decisions, and thus they remain unclear in part. Therefore, the Ministry of Justice has been conducting a study to reform the collateral law system, especially to clarify the rules for collateral over movables and claims.

In relation to this, the FSA has established a study group and has discussed with experts the possibility of a system under which a business as a whole could be provided as security for financing. In December 2020, the study group presented the concept of a “Business Growth Security Interest”, which is expected to have advantages such as:

- the new security interest focusing on business value, including intangible assets, can promote financing businesses with no or limited tangible assets;
- it can facilitate financing in the restructuring phase (e.g. DIP financing); and
- it can encourage security holders, through the monitoring process of the security, to understand the debtor’s business better, which could make it easier to reach an agreement on a restructuring plan in the restructuring phase.

As there are still various points to be considered regarding the reform of the collateral law system and the new security interest, further discussions will be held before they can be put into practice. Considering the purposes of the reform and the new security interest, they could assist MSMEs by increasing their access to financing in the restructuring phase.

4. Moving Ahead

We conducted an interview with Mr Takashi Sonoo and Mr Akimitsu Takai, who are renowned insolvency practitioners in Japan.

Mr Takashi Sonoo is a former Judge and has experience serving as the Chief Judge of the Division in Charge of Bankruptcy and Civil Rehab at the Tokyo District Court (20th Civil Division). He is famous for the invention of a new form of implementation of bankruptcy proceedings, which is easy for individual debtors and MSMEs to use, when he was Chief Judge. He is also well known as an experienced insolvency practitioner based on his career after he retired as a judge and became a lawyer.

Mr. Akimitsu Takai is an attorney-at-law who is famous in the field of restructuring and insolvency workouts. As an executive director of the Small and Medium Business Legal Support Centre at the Japan Federation of Bar Associations (JFBA), he played a leading role in establishing the JFBA Guidelines, which were proposed by the JFBA to support MSMEs executing a quick turnaround or winding up of their business. Through this experience, he has intimate knowledge of the restructuring of MSMEs.

4.1 Best way to safeguard the interests of MSMEs

Mr. Sonoo points out that Japan's current formal insolvency procedures do not improperly undermine MSMEs' interests. Before 2000, bankruptcy proceedings were too expensive and time-consuming for MSMEs to meet the needs for the winding up of their businesses. In addition to that, the status of being bankrupt had a strong negative image and there was strong public sentiment against bankruptcy at that time. Consequently, bankruptcy proceedings were nothing but an object of fear for MSMEs and were considered mainly as a tool for creditors to threaten their debtors.

This situation has dramatically changed with the nationwide spread of the new implementation of bankruptcy proceedings – that is, special treatment in cases of small-scale debt mentioned in section 1.1.3 above – that Mr Sonoo first devised and implemented at the Tokyo District Court beginning around 2000.

Thanks to this new implementation, MSMEs, including individuals, can now obtain relief through bankruptcy proceedings cheaply and quickly. Also, under the civil rehab process enacted in 2000, rehabilitation debtors have been able to pay their debts to minor creditors with the permission of the court. This new mechanism has relieved MSMEs that are acting as a supplier to medium and large companies and that enter civil rehab from some of the fear of defaulting. Due to such changes in the legal system related to Japanese insolvency and its implementation, Mr Sonoo points out that since the 2000s, Japan's formal insolvency system has been able to adequately protect the interests of MSMEs in both its system and its

implementation. However, he also says that there is still some room for improvement towards the elimination of the negative image regarding insolvency and further protection of the interests of MSMEs (see section 4.3 below for more information on this point).

Mr Takai emphasises the importance of protecting the value of MSMEs' businesses. This "value" includes not only financial value (cash flow generated by the MSMEs' businesses), but also the social importance of the business, such as being an indispensable part of a supply chain or creating employment in a specific area. Mr Takai suggests that out of court workouts should be tried first so that MSMEs can maintain stable business relationships with the large companies that are their important clients, and the best way to protect the MSMEs' value should be explored throughout that procedure.

In this respect, there is a widespread practice of out of court workouts for restructuring debts incurred by management (including guarantee obligations for company loans) based on the "Guidelines for Management's Guarantees" in Japan. These Guidelines are a set of rules established voluntarily by a study group consisting of experts and relevant parties, including SME associations and financial institution associations. By using this framework together with proper out of court workouts for MSMEs, it would be possible to restructure the excessive debts of MSMEs and their management at once and in a consistent manner.

Incidentally, Mr Takai does not exclude the fact that avoiding the negative image of pursuing formal insolvency procedures by choosing an undisclosed out of court workout may help protect the interests of MSMEs (or their managers), but he also claims this should not be a top priority. He states that the use of formal insolvency proceedings should be considered a realistic option if it is suitable or necessary to protect the value of MSMEs' businesses.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Mr Sonoo's views on Japanese formal insolvency proceedings are described in section 4.1 above.

Mr Takai agrees with Mr Sonoo's views that the current formal insolvency proceedings are helpful, not harmful, for MSMEs. In particular, he points out that since the enactment of the Civil Rehabilitation Act in 2000, people have become more open-minded about MSMEs restructuring their businesses, and hence the psychological barrier for MSMEs against formal insolvency has been lowered. Also, creditors (mainly financial institutions) have become more sophisticated regarding formal insolvency proceedings and have become more supportive of borrowers (MSMEs) in the process of civil rehab once the proceedings start. Because of those changes in the circumstances surrounding the restructuring of MSMEs, Mr Takai concludes that, currently, formal insolvency proceedings can be referred to as supportive tools for MSMEs.

There has been no significant change in laws (including subordinate legislation) after the beginning of the COVID-19 pandemic with regard to the restructuring of MSMEs in Japan. However, to support MSMEs' businesses under the harsh economic conditions caused by the pandemic, the Japanese Government has provided a significant amount of liquidity to MSMEs directly (e.g. provision of

special subsidies to negatively affected MSMEs) and indirectly (e.g. the implementation of loan programs guaranteed by Government agencies). As a result of those measures, the number of formal insolvency cases has remained relatively low over the past year in Japan.

Mr Takai found the support from the Government to be quite meaningful as a relief for MSMEs given the harsh economic conditions experienced due to COVID-19. However, he also points out that the problem would be how to wind up the support once the pandemic is over. He worries that if the current measures continue even after the end of the pandemic, it might cause MSMEs to miss the timing for a fundamental restructuring of their business and thereby diminish the vitality of the country's whole economy, as the excessively long-lasting support from the Government based on the SME Financing Facilitation Act and its successive laws and practices once undermined the vitality of the economy.

To avoid such a situation, Mr Takai recommends that the current special Government support to MSMEs should be wound back after the pandemic, unless there is an absolutely necessity (e.g. if a state of emergency is declared again). At the same time, he suggests that a system be developed to look after MSMEs which may face difficulties in continuing their business due to the eventual decrease in Government support. Such a system should have specialists who have expertise in management support provide advice on business restructuring. Additionally, further dissemination of easy and quick out of court workouts under certain rules should be put in place. According to Mr Takai, as a part of such a support system, the JFBA is currently working with the Small and Medium Enterprise Agency regarding the establishment of a public support system for MSMEs' M&A for business succession.

Mr Sonoo forecasts that MSMEs will continue to receive support for a while. However, he also worries that the continuation of the current situation would prevent people involved with the revitalisation of MSMEs from becoming aware of the need for a fundamental restructuring of MSMEs' businesses. As a measure to overcome this situation, Mr Sonoo recommends the implementation of new rehabilitation proceedings that are easy for MSMEs to use and that enable MSMEs to achieve business restructuring without abruptly terminating their businesses. The details of his proposal are stated in section 4.3 below.

4.3 Simplified insolvency proceedings

For further and faster relief of distressed MSMEs, Mr Sonoo emphasises the necessity of new forms of implementation of civil rehab that are simpler than the current standard implementation. Civil rehab is one of the reconstructive insolvency proceedings based on the Civil Rehabilitation Act and is widely used to restructure distressed businesses of various sizes. However, since the established implementation of the proceedings requires the appointment of proven bankruptcy lawyers as supervisors in order to avoid abuse of the procedures, the process as a whole tends to be too complicated and time consuming for MSMEs, which in many cases do not have enough resources.

Also, because of these complicated proceedings, the procedural fee for civil rehab is relatively high for many MSMEs. That issue is said to be a factor preventing MSMEs from utilising civil rehab. Considering those problems, Mr Sonoo points

out that it would be necessary to establish a simple and fast proceeding for small companies to restructure their business by reviewing the implementation of civil rehab, referring to Chapter 11, Subchapter V in the United States Bankruptcy Code (which is a simplified version of the larger and more complex process under Chapter 11). The reason why he advocates for the establishment of the new proceedings through operational changes rather than legal reforms is that changing the implementation is much easier than changing laws, and hence it is preferable to quickly address the pressing issue of the relief of MSMEs in the post COVID-19 era.

According to Mr Sonoo, a branch of a District Court in the Tohoku region established a new implementation of civil rehab based on the principles stated above, but it has not yet been fully utilised. Mr Sonoo says that given the persistent negative image of formal insolvency proceedings in regional areas, it would be desirable to start such an implementation in urban areas like Tokyo where psychological resistance to formal insolvency proceedings is relatively weak, and then gradually spread nationwide in order to promote a new implementation.

On the other hand, Mr Takai points out that there needs to be generally accepted rules for an out of court workout that can provide a clear path to revitalisation or discontinuation of MSMEs' businesses. It is estimated that there are more than 50,000 cases of business closures, including de-facto closures, without formal insolvency or dissolution proceedings among MSMEs per year in Japan, and a significant percentage of these cases are ones without clear procedures in place and under chronic deficit. No legal discharge will be given to MSMEs and their managers in such cases. Therefore, Mr Takai concludes that there would be a high potential need for a useful out of court workout protocol for MSMEs that allows for clear business discontinuation (or business turnaround if the situation permits).

The JFBA Guidelines are exactly the protocol that was designed to meet such needs, and Mr Takai intends to promote the further utilisation of the Guidelines in the future. According to Mr Takai, the JFBA is currently considering the implementation of a mechanism to obtain opinions on the proposed plan for rehabilitation or discontinuation of a business from a person with a certain level of authority in the proceedings under the JFBA Guidelines to further promote the use of the Guidelines. Such opinions may make it easier for financial institutions as creditors to agree to the restructuring of MSMEs using the Guideline.

**GROUP OF THIRTY-SIX**

AlixPartners LLP
Allen & Overy LLP
Alvarez & Marsal
Baker McKenzie
Baker Tilly
BDO
Brown Rudnick LLP
Clayton Utz
Cleary Gottlieb Steen & Hamilton LLP
Clifford Chance LLP
Conyers
Davis Polk & Wardwell LLP
De Brauw Blackstone Westbroek
Deloitte LLP
Dentons
DLA Piper
EY
Freshfields Bruckhaus Deringer LLP
FTI Consulting
Galdino & Coelho Advogados
Grant Thornton
Greenberg Traurig LLP
Harneys
Hogan Lovells
Houthoff
Interpath
Jones Day
Kalo
King & Wood Mallesons
Kirkland & Ellis LLP
KPMG LLP
Kroll
Linklaters LLP
Morgan Lewis & Bockius LLP
Norton Rose Fulbright
PwC
Quantuma
Rajah & Tann Asia
RSM
Shearman & Sterling LLP
Skadden, Arps, Slate, Meagher & Flom LLP
South Square
Sullivan & Cromwell LLP
Teneo
Troutman Pepper
Weil, Gotshal & Manges LLP

MEMBER ASSOCIATIONS

American Bankruptcy Institute
Asociación Argentina de Estudios Sobre la Insolvencia
Asociación Uruguaya de Asesores en Insolvencia y Reestructuraciones Empresariales
Asociación Profesional de Administradores Concursales Sainz de Andino
Associação Portuguesa de Direito da Insolvência e Recuperação
Association of Business Recovery Professionals - R3
Association of Restructuring and Insolvency Experts (Channel Islands)
Association of Turnaround and Insolvency Kenya Ltd
Australian Restructuring, Insolvency and Turnaround Association
Bankruptcy Law and Restructuring Research Centre, China University of Politics and Law
Business Recovery and Insolvency Practitioners Association of Nigeria
Business Recovery and Insolvency Practitioners Association of Sri Lanka
Business Recovery Professionals (Mauritius) Ltd
Canadian Association of Insolvency and Restructuring Professionals
Commercial Law League of America (Bankruptcy and Insolvency Section)
Especialistas de Concursos Mercantiles de Mexico
Finnish Insolvency Law Association
Ghana Association of Restructuring and Insolvency Advisors
Hong Kong Institute of Certified Public Accountants (Restructuring and Insolvency Faculty)
INSOL Europe
INSOL India
Insolvency Practitioners Association of Malaysia
Insolvency Practitioners Association of Singapore
Instituto Brasileiro de Estudos de Recuperação de Empresas
Instituto Iberoamericano de Derecho Concursal
Instituto Iberoamericano de Derecho Concursal – Capitulo Colombiano
International Association of Insurance Receivers
International Women’s Insolvency and Restructuring Confederation
Japanese Federation of Insolvency Professionals
Korean Restructuring and Insolvency Practitioners Association
Law Council of Australia (Business Law Section)
Malaysian Institute of Accountants
Malaysian Institute of Certified Public Accountants
National Association of Federal Equity Receivers
NIVD – Neue Insolvenzverwaltervereinigung Deutschlands e.V.
Recovery and Insolvency Specialists Association (BVI) Ltd
Recovery and Insolvency Specialists Association (Cayman) Ltd
Restructuring and Insolvency Specialists Association (Bahamas)
Restructuring and Insolvency Specialists Association of Bermuda
Restructuring Insolvency & Turnaround Association of New Zealand
South African Restructuring and Insolvency Practitioners Association
Turnaround Management Association (INSOL Special Interest Group)
Turnaround Management Association Brasil (TMA Brasil)
Xiamen Association of Bankruptcy Administrators (XMABA)



INSOL
INTERNATIONAL

