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Cross-Border Restructurings in JAPAN

Japan's economy has stalled over the last years. A low GDP rise of only 1.35% coincides with a steep rise in public debt. The old and new government of prime minister Shinzo Abe is still hesitant to implement any serious structural reforms. Our experts Toshiaki Nakada, Ulrich Kirchhoff, LL.M. (ARQIS Foreign Law Office, Tokyo) and Dr. Ruediger Theiselmann (WELLENSIEK, Frankfurt) discuss the impacts this situation has on German international groups and their companies in Japan.

Do risks of overriding importance exist for German companies in Japan?

Theiselmann: The Japanese government tried to stimulate export by easing the monetary policy. Additionally, it increased the rate of inflation raising VAT to 8% in April 2014 – however, these measures lead back to recession. Meanwhile, the inflation rate is gradually declining to normal levels. Against this backdrop, it is not sure whether Shinzo Abe can deliver on his election promises for higher wages to increase consumer spending and ultimately overcome deflation.

How does all this affect German companies doing business in Japan?

Theiselmann: Should domestic demand not bounce back this could create longer-lasting negative effects on German manufacturers of consumer goods. On the other hand a sudden rise in wages may well have negative consequences for the already hard-pressed Japanese automotive, steel and technology sectors – and along with these also for local German component suppliers.

What should German companies be aware of if its Japanese subsidiary is in a financial crisis?

Nakada: In Japan, no strict legal obligation for the management of a company to file for insolvency or reorganization procedures exists. This is why a company in Japan, even if continuously over-indebted, may still continue to exist as long as it can honor at least some of its debts. It is also important to note that on the shareholders' level no strict legal obligation to provide additional funds to the subsidiary exists in Japan.

Kirchhoff: Due to the potential negative effect on the reputation of the debtor and creditor, creditors rarely initiate an insolvency filing in Japan, although this is legally possible. More commonly found are informal negotiations between the debtor and its creditors, often followed by private arrangements including waivers of claims in order to avoid a financial collapse of the debtor. Even if a creditor initiates an insolvency filing, the insolvency procedure will typically not be initiated if the debtor can sufficiently prove continuing payment of its debts.

Which insolvency reasons and obligations does Japanese law provide for?

Nakada: The legal grounds for an insolvency filing in Japan are (i) insolvency, i.e. the debtor is generally and on a permanent basis not able to pay its debts at the due date, (ii) impending insolvency (the debtor has suspended payments to one or more creditors), (iii) excess of debts over

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assets, and (iv) pending insolvency proceedings against the debtor in a foreign jurisdiction. Even though Japanese insolvency regulations do not provide for a general obligation of the management to apply for bankruptcy proceedings within a certain period of time after the confirmation of the respective insolvency reasons, the management of a Japanese corporation may still be personally liable vis-à-vis the creditors of the company, in case it has acted in violation of its general duty of care and/or fiduciary duties as a corporate director.

What do you do when a foreign client mandates you with a restructuring project in Japan?

Theiselmann: Just recently we had to assess a potential insolvency scenario for a German client's subsidiary in Japan. First thing we involved local experts from our network to check on the existence of insolvency reasons from a legal and financial point of view. We coordinated the flow of information between the client's financial department and the local experts. Apart from the translations and transfer of information in strictly technical terms this comprises the uncovering and explanation of cultural and legal differences.

How time and cost consuming is the liquidation of a Japanese subsidiary if the financial situation permanently deteriorates?

Nakada: Based on our experience, the completion of the liquidation procedure generally takes approximately six to twelve months, depending on whether the settlement of accounts, if any, can be achieved in a timely manner. The settlement of accounts includes the repayment of any obligations vis-à-vis the company's creditors or alternatively the waiver of the repayment right by the creditor. The major costs of a liquidation procedure are typically the costs for ending employment relations to the company. The amount of a voluntary severance payment offered and agreed is subject to negotiations between the parties.

Under what circumstances is the liquidation of a Japanese company preferable to an insolvency proceeding?

Kirchhoff: Given the fact that reputation is a key asset for doing business in Japan and that in most cases investors plan to continue distribution even after the closure of its subsidiary in Japan, the liquidation procedure is typically preferable to an insolvency procedure. The liquidation procedure has the advantage that it can be controlled by the shareholder(s) because it does not involve a court appointed insolvency administrator. Whether or not a liquidation procedure is feasible, often depends on the creditor structure of the subsidiary. In many cases the major creditor of a Japanese subsidiary is its parent company which may, for example, waive its right to receive loan repayment.

Many thanks for the interesting discussion, Mr. Nakada, Mr. Kirchhoff and Mr. Theiselmann.

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