Reorganization of Insolvent Companies Under The New Reorganization Law

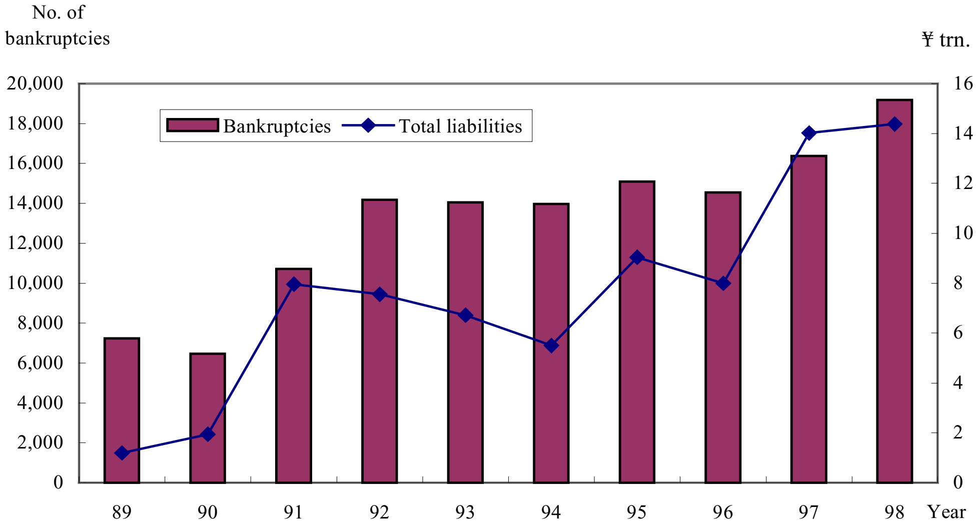
Masanobu Iwatani

In December 1999 the Japanese Diet passed the Reorganization Law, a successor to the Composition Act that regulates the rehabilitation of bankrupt companies. The new law is set to go into force from April 2000. This report will examine the changes to Japan's bankruptcy proceedings that the passing of the Reorganization Law entails. We will also draw attention to Japan's arrangements for providing finance to bankrupt debtors being rehabilitated under the new law, and will also draw comparisons with the system in the U.S..

1. Current Levels of Corporate Bankruptcy in Japan

According to data published by the private credit research agency Teikoku Databank, the 19,171 corporate failures in 1998 represented the second highest number of corporate bankruptcies in Japan since 1945 (the highest being the 20,841 firms that went bankrupt in 1984). The total value of debts left behind by insolvent companies, at a total ¥14.38 trillion, was however the worst figure over the same period (Figure 1). Further, bankruptcies directly attributable to economic recession[1] topped 70% for the first time.

Figure 1 Cases of Corporate Bankruptcy and Value of Insolvent Debts.



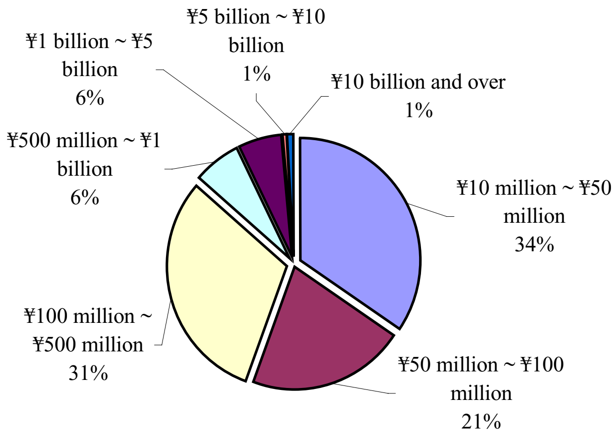
Source: NRI, from "Corporate Bankruptcy Statistics (1998)" Teikoku Databank

[1] Recession related bankruptcies are defined as those whose main cause is either poor sales or export performance, difficulty in recovering trade receivables, accumulated bad debts, or general poor conditions in the industry.

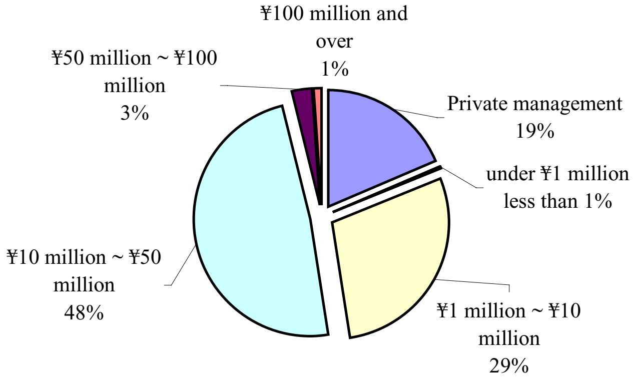
While the number of companies leaving over ¥1 billion in insolvent debts increased, the relative proportions of bankrupt companies according to debt liabilities and capital showed little change on the previous year. The majority of failures continued to occur among small to medium size enterprises with equity capital of under ¥100 million (Figure 2). In order to counter the reluctance of financial institutions to lend, the government instituted its "Special Loan Guarantee Scheme For The Financial Stabilization Of Small To Medium Size Enterprises" in October 1998, operated by the Credit Guarantee Corporation. Subsequent relaxation of the conditions for obtaining credit guarantees, backed by the assistance of other government-run financial institutions, did not however result in any fundamental solution to the problem. Bankruptcies due to the credit-crunch increased dramatically, totaling 759 cases for 1998, 2.4 times the number of the previous year.

Figure 2 No. Of Bankruptcies By Value Of Insolvency Debts / Equity Capital

No. of Bankruptcies by Total Value of Insolvency Debts (1998)



No. of Bankruptcies By Equity Capital Of Insolvent Company (1998)



Source: NRI, from "Corporate Bankruptcy Statistics (1998)," Teikoku Databank

The above shows that the situation regarding corporate bankruptcies is as bleak as ever. However, when we examine the subsequent course of action, we find that fully 84% of the companies go through "work out" (also called "turn around"), which does not subject the company to court administration for bankruptcy as would happen with liquidation or reorganization. The number of bankrupt companies who were dealt with in accordance with the legal processes set out in the Bankruptcy Act, the Stock Company Reorganization and Rehabilitation Law (hereafter the Corporate Rehabilitation Law), or the Composition Act, or under Commercial Law special liquidation or company liquidation rules, was only 15%. Further, out of those companies who were disposed of via legal process, 85% of them were liquidations carried out under the Bankruptcy Act, with very few cases of company rehabilitation under the Corporate Rehabilitation Law or Composition Acts, or as company liquidation under the Commercial Law.

2. Japan's Current Bankruptcy Laws And Related Problems

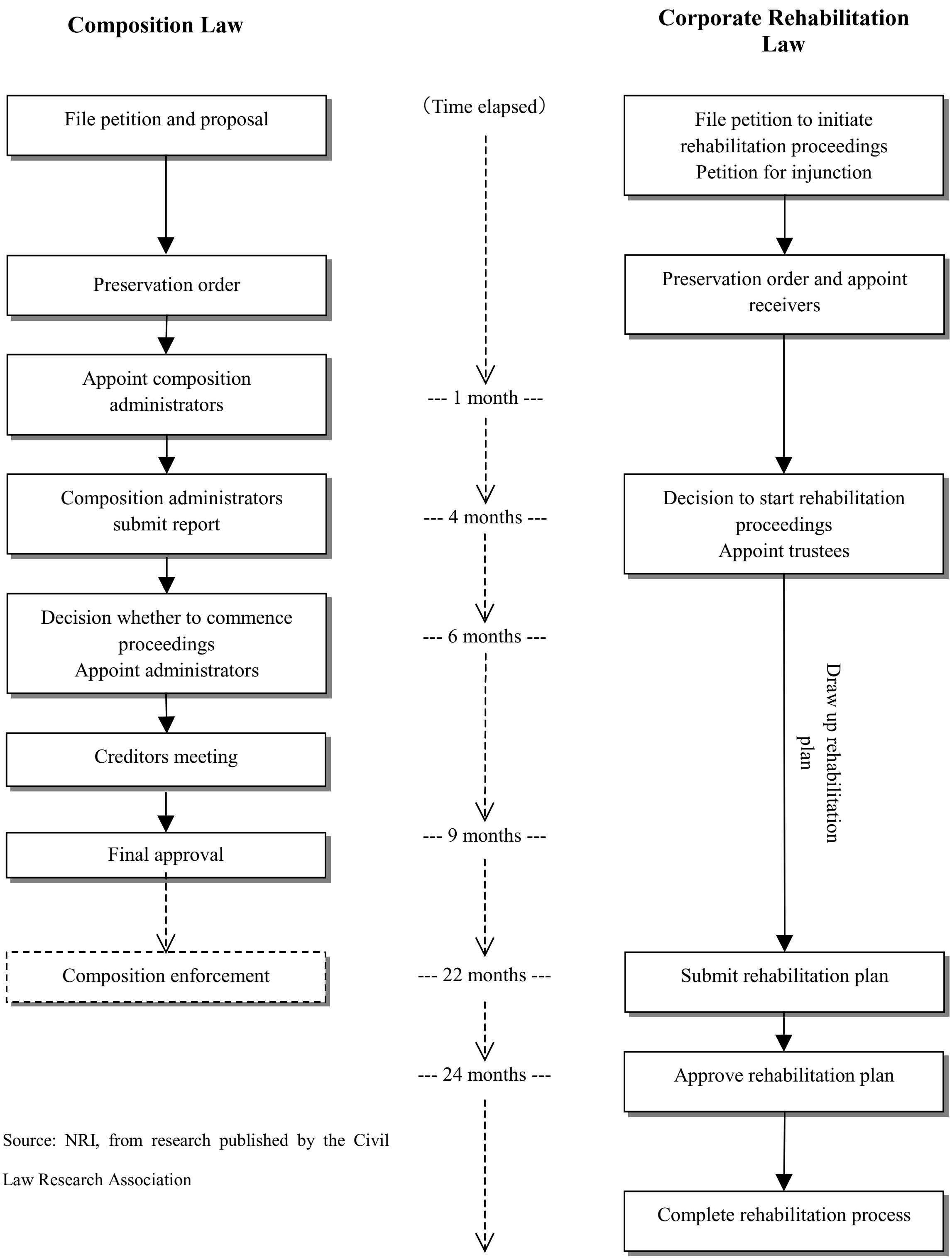
Japan has a total of five legal processes by which companies can file for bankruptcy, divided broadly into two types: liquidation proceedings (under the Bankruptcy Act or special liquidation under the Commercial Code); and reorganization proceedings (under the Corporate Rehabilitation Law, the Composition Act, or company liquidation under the Commercial Code). Here we will concentrate on rehabilitation type proceedings, highlighting problems with existing legislation by comparing the Corporate Rehabilitation Law and Composition Law.

(1) Legal entities permitted to petition for rehabilitation and undergo rehabilitation proceedings

If an insolvent company elects to be reorganized rather than liquidated, then the process begins with the filing of a petition for reorganization. In the case of the Composition Law, while it is applicable to either a corporation or a natural person, it is only the creditors who can petition to initiate the process (Composition Law, Article 12). On the other hand, the Corporate Rehabilitation Law only covers joint-stock companies (Corporate Rehabilitation Law, Article 1).[2] However, in comparison to the Composition Law, the Corporate Rehabilitation Law is both complicated, costly (trustee remuneration and other expenses), and time-consuming, and is therefore generally regarded as being suitable mainly for large companies. The relatively simple Composition Law in contrast is regarded as suitable for small to mid-size enterprises. Figure 3 compares the processes involved in reorganization under these two laws.

[2] However, creditors with loans extended amounting to 10% or more of the equity capital, or shareholders who hold 10% or more of the total outstanding share issuance of the debtor company, may also in certain circumstances be permitted to file a petition (Company Rehabilitation Law, Article 30).

Figure 3 Typical Processes Involved in Company Administration under the Composition Law and Corporate Rehabilitation Law


Composition Law
Corporate Rehabilitation Law
File petition and proposal
Preservation order
Appoint composition administrators
Composition administrators submit report
Decision whether to commence proceedings
Appoint administrators
Creditors meeting
Final approval
Composition enforcement
（Time elapsed）
--- 1 month ---
--- 4 months ---
--- 6 months ---
--- 9 months ---
--- 22 months ---
--- 24 months ---
File petition to initiate rehabilitation proceedings
Petition for injunction
Preservation order and appoint receivers
Decision to start rehabilitation proceedings
Appoint trustees
Draw up rehabilitation plan
Submit rehabilitation plan
Approve rehabilitation plan
Complete rehabilitation process

Source: NRI, from research published by the Civil Law Research Association

(2) Reasons for initiation

The Corporate Rehabilitation Law specifies two permissible grounds for initiating rehabilitation proceedings: firstly, if the company anticipates an event occurring that would push it into insolvency; secondly, if the company is not able to repay any debt on the maturity date without seriously impairing its ability to continue business (Corporate Rehabilitation Law, Article 30). While these are fairly broad conditions, in contrast the Composition Law stipulates that the company must be technically insolvent before it can initiate proceedings. Consequently, many companies apply for protection under the Composition Law after they have become unable to repay their debt (Bankruptcy Act, Article 126), or have an excess of liabilities over assets (Bankruptcy Law, 127) – essentially when the company is already beyond being helped. In addition, to petition for the commencement of Composition Law proceedings a company must submit proposed composition conditions to the court at the time of making the petition.(Composition Law, Article 13)

(3) Company management

From the management point of view however, while initiation of reorganization proceedings under the Composition Law is more difficult, it appears to offer a smoother path to recovery. Composition Law permits the incumbent management to continue running the company (Article 32). In contrast, under the Corporate Rehabilitation Law the court appoints trustees at the time that the decision to commence proceedings is made who have the sole responsibility of both managing the company and managing and disposing of assets (Articles 46,53). For the incumbent management, continuing running the company after petition is more attractive.

(4) Loan procurement

Where an insolvent company procures working capital in order to carry on its business operations, the Composition Law stipulates that the borrower may not use this capital for business outside its normal activities during the period between the filing of the petition to initiate proceedings and the court decision to do so (Article 31). After proceedings have been initiated, it needs the agreement of the appointed trustees in order to use capital acquired in this way for non-regular activities (Article 32). Use of borrowed funds for non-regular activities are thus prohibited until the proceedings are under way. On the other hand, the Corporate Rehabilitation Law stipulates that the trustees need to obtain the court's permission in order to borrow funds (Article 54), and that the claim on these funds should take the form of rights of common-interest[3] (Articles 119-3 and 208).

[3] "Rights of common-interest" are claims on funds employed to pay off expenses used for the purpose of gaining profits for several parties jointly, which would include such things as lawyer fees and employee salaries paid during the course of the rehabilitation proceedings. It is repaid throughout the term of the rehabilitation and at a higher priority than any previous debts incurred that may have been the cause of rehabilitation proceedings (Article 209). The Composition Law on the other hand does not make any specific provision for recognizing rights of common-interest for loans procured.

(5) Other

The approach of the courts regarding rehabilitation under the Corporate Rehabilitation Law is criticized by some for being over-rigorous, resulting in rehabilitation proceedings taking an unnecessarily long time. Further, the court may reject an application on the grounds that it thinks the company has poor prospects for making a recovery (Article 38). In practice, say critics, the courts tend to interpret this in a negative fashion, in effect not approving applications unless the company appears to have particularly good prospects for making a recovery.

The Composition Law, on the other hand, is criticized for not explicitly stipulating legal procedures to aid in deciding on a rehabilitation plan, as is the case with the Corporate Rehabilitation Law (Article 222, second paragraph). Further, two weeks after the decision to approve the composition the terms take effect (Composition Law, Articles 7, 54), at which point the composition proceedings are completed. The actual enforcement of the composition conditions agreed are not however supervised by the courts, and consequently there have been many cases where the conditions have not been actually enforced. It is also criticized for only being binding on regular creditors but not on secured creditors (Articles 41, 42).

The Corporate Rehabilitation Law and the Composition Law both therefore have their advantages and disadvantages. The difficulties surrounding their application however have obviously warned companies away, as given the large number of bankruptcies the proportion of companies who lodge applications for rehabilitation under these laws has remained small.

3. The Reorganization Law

1) Purpose Of The New Reorganization Law

The Reorganization Law, promulgated on 17 December 1999 and set to come into force from 1 April 2000, was originally envisaged as a replacement for the Composition Law, in order to provide fresh legal procedures for SMEs to rehabilitate their businesses at a time when, after the bursting of the asset price bubble, the recession-prone Japanese economy was experiencing a credit-crunch. The reluctance of financial institutions to lend to SMEs was leading to a large number of bankruptcies. The law’s primary aim was to make up for the defects in existing corporate rehabilitation legislation, as detailed above, to speed up and simplify the processes involved and to ensure that any reorganization plans were implemented (Table 1).

Table 1 Comparison of the 3 Major Pieces of Corporate Rehabilitation Legislation

	Reorganization Law	Composition Law	Corporate Rehabilitation Law
Legal entities permitted to file a petition or to be subject to rehabilitation proceedings	Corporations or natural persons may be subject to proceedings As a rule the petitioner would be the debtor to be rehabilitated, though it is also possible for the creditors to file for reorganization proceedings if they fear that certain circumstances will arise that would push the debtor into insolvency	Corporations or natural persons may be subject to proceedings Only the debtor may file a petition, and if the debtor is a corporate entity, then a consensus among the company directors (or equivalent persons) is required	Only limited (joint-stock) companies may be subject to proceedings Creditors extending credit to the company equivalent to 1/10th or more of the equity capital of the company, or shareholders holding 1/10th or more of total outstanding share issuance may file a petition
Conditions for filing a petition	Where there is concern that certain circumstances will arise that would push the company into insolvency Where the debtor is unable to repay any debt on the due date without severely impairing the company's ability to continue with business operations	Where the company is technically insolvent	Where there is concern that certain circumstances will arise that would push the company into insolvency Where the debtor is unable to repay any debt by the due date without severely impairing its ability to continue with business operations
Provisional management	If no trustees have been appointed, then the incumbent management of the debtor continue to run the company If deemed necessary, then trustees, supervisors, examiners or receivers can be appointed.	Debtor company continues to run its own business	Company is run solely by trustees
Creditors' committee	Subject to the approval of the court, and by fulfilling the following three conditions, the creditors' committee may have a say in the reorganization process by submitting a declaration of its views regarding court decisions or the debtor company: (1) The number of creditors at the committee is between 3 and the maximum number as stipulated by the Supreme Court (2) The creditors' committee has the approval of the majority of creditors that it can participate in the reorganization process (3) The court recognizes that the creditors' committee is acting in the interests of all the creditors	No relevant regulations	・No relevant regulations

	Reorganization Law	Composition Law	Corporate Rehabilitation Law
Loan procurement	Subject to court approval Claims on the funds borrowed between the filing of the petition and the initiation of reorganization proceedings are classed as rights of common-interest with the approval of the court, and those borrowed after the initiation of the reorganization process are automatically classed as rights of common-interest	Approval of the trustee required if the borrowed funds are to be used for purposes outside that company's regular business	Subject to court approval Claims on the funds borrowed are classed as rights of common-interest
Approval of rehabilitation plan	Approval by over half of attending creditors with voting rights, and that those approving represent 1/2 or more of total voting rights	Approval by over half of attending creditors with voting rights, and that those approving represent 3/4 or more of total voting rights	Creditors: approval by 2/3 or more of total voting rights Secured creditors: approval by 4/5 of total voting rights required to order a reduction or exemption.
Ensuring enforcement of reorganization plan	If the court has appointed supervisors then these will oversee the implementation of the reorganization plan	Enforcement of composition conditions is not subject to court supervision	Trustees are to proceed with immediate implementation of the rehabilitation plan. If the incumbent board of directors is running the company through the duration of the rehabilitation process, then the trustees are to oversee its implementation.

Source: NRI

2) Main Characteristics Of The New Reorganization Type Bankruptcy Proceedings

In this section we will explain the main features of the new Reorganization Law in so far as they constitute revisions to the Composition Law and Corporate Rehabilitation Law, and relate to short term financing of the company being reorganized. The term "debtor" is used to signify the insolvent company that filed a petition for the initiation of reorganization proceedings.

(1) Legal entities petitioning for and undergoing reorganization proceedings

The Reorganization Law was established to provide a new set of proceedings for the reorganization of bankrupt companies with SMEs. But, as all corporations or natural persons may file a petition, it is likely that large companies in addition to SMEs will invoke it. Further, unlike the Composition Law, creditors may also file a petition (Article 21).

(2) Conditions for filing a petition to initiate reorganization proceedings

The new legislation has been designed to counter criticism of the Composition Law, that the discretion and severity of its application resulted in it only being invoked once a company was past any hope of being saved. The Reorganization Law, in common with the Corporate Rehabilitation Law, has more relaxed conditions. It allows for a petition where there is concern that certain circumstances will arise that would push the company into insolvency or where the debtor is unable to repay any debt on the due date without severely impairing its ability to continue with business operations (Article 21). This allows for reorganization proceedings to be initiated in time to offer a reasonable chance of success.

(3) Provisional management of the company

In common with the Composition Law, the Reorganization Law allows the incumbent management to continue managing the company and to dispose of its assets (Article 38) subsequent to the initiation of reorganization proceedings. However if the court deems it necessary it may, as per the Corporate Rehabilitation Law, appoint receivers to manage the business between the filing of the petition and the decision whether to commence reorganization proceedings (Article 79), or to appoint trustees to do the same once the reorganization process has begun (Article 64). Apparently, concerned that if the incumbent management were to be prohibited from running the company once the reorganization proceedings had started then it might result in management being more reluctant to file a petition and therefore delay the process of reorganization, and also considering that it would probably smooth the reorganization process if the incumbent management, already familiar with the business practices and customs of their own business field, rather than inexperienced outside trustees were to run the company, the legislators chose to combine features of both the Composition Law and the Corporate Rehabilitation Law. As a result, now large companies, many of which choose reorganization over liquidation, will have two choices: either continue in business and restructure autonomously as the debtor company under the Reorganization Law, or transfer the reins of the business to trustees under the Corporate Rehabilitation Law.

(4) Reorganization funding

Under the Reorganization Law, as is the case with the Corporate Rehabilitation Law, court approval is required in order for the debtor to raise working capital in order to continue business operations (Article 41). Claims on this working capital are then treated as rights of common-interest, either by court approval during the period between the debtor filing the petition to initiate reorganization proceedings and the commencement of those proceedings, or automatically once proceedings have commenced. These rights of common-interest then have a higher priority of repayment than reorganization debts (debts incurred due to circumstances arising prior to commencement of reorganization proceedings) (Articles 119 ~ 121). This means, for example, that if an insolvent company receives funds for working capital from one of its clients after the company has filed for reorganization, that the client is always entitled to repayment of those funds, even if no method of repayment of reorganization debts has been agreed to as part of the reorganization plan.

While the Corporate Rehabilitation Law stipulates that claims on such loans could be treated as rights of common-interest, the Composition Law did not. The new legislation therefore clarifies this point.

(5) Ensuring implementation

Since the problem frequently arose with the Composition Law that the conditions agreed to were not implemented, the new legislation stipulates new procedures to ensure implementation in accordance with the terms agreed. Firstly, the Reorganization Law provides for supervisors[4] to be appointed to ensure implementation (Article 186). Secondly, when the court approves the reorganization plan, a court secretary will write down the terms on the record of reorganization creditors[5], and the details of the rights of the creditors written down there will have the same legal force as a final judgement of the court. Consequently, creditors can then force compliance regarding monetary debts against non-fulfillment of the plan (Article 180). With the above provisions it is expected that reorganization plans drawn up under the Reorganization Law will be enforced more rigorously than was the case under the Composition Law.

(6) Other

There are several additional regulations that distinguish the Reorganization Law from previous legislation. Firstly, it is possible to cancel secured rights on “vital” assets of the debtor, the claim of which would severely impair the debtor’s ability to continue business operations, by paying an amount equivalent to the appraisal value of the collateral to the court (Article 148).[6] For example, if the insolvent company is a manufacturer, and the factory used to manufacture its products is used as collateral for credit, then this secured right can be cancelled by paying the liquidation value of the factory. Incidentally, this regulation does not appear to have any equivalent in US federal law.

Secondly, after initiation of reorganization proceedings, subject to court approval, the debtor may transfer some or all of its operations to another party before the reorganization plan is completed (Article 42). For example, if another company wishes to buy a division of the debtor before the operational assets decline in usefulness, then under the new legislation it would be possible to carry this out with a minimum of delay.

Thirdly, if the debtor is a limited company, it is possible to include a capital decrease as part of the reorganization plan (Article 161). Under the Composition Law it was extremely difficult to carry out a capital decrease. Making this process simpler enables a debtor to carry out a 100% capital decrease and then issue new equity to its creditors, carrying out in effect a debt-equity swap.

Finally, if it meets certain conditions the debtor may qualify for a simplified reorganization procedure that does not require a credit examination (Article 200), or a consensual reorganization procedure that neither requires a credit examination or a vote of approval at a creditors’ meeting of the reorganization plan (Article 206). This would smooth the reorganization process considerably.

[4] If the court deems it necessary, by the petition of interested parties or by virtue of their authority, supervisors may be appointed by order of the court. The agreement of the supervisors is required if the debtor intends to carry out any actions specified by the court in this supervisory order.

[5] A document, drawn up by the court secretary, of “duly notified reorganization debts” and “reorganization debts not duly notified but recorded by the debtor .”

[6] The amount paid to the court is then disbursed to the holder of the collateral claim (Article 153).

4. Loan Procurement By Insolvent Firms Under Current Bankruptcy Legislation

Here we will examine the financing of a company undergoing reorganization proceedings, and begin by explaining the situation under current legislation.

Usually under insolvent company rehabilitation proceedings, an injunction petition is also filed at the same time as the filing of the petition for rehabilitation, for which the court will issue a preservation order that halts debt repayments, the disposal of assets, and further debt financing. Receivers, in most cases lawyers, will be appointed to administer the continuation of the insolvent company's regular business until a decision is made on whether to start rehabilitation proceedings. In addition the receivers will search for a third-party company to sponsor the insolvent company, and request that this "sponsor" is appointed as the trustee. It would not be going too far to say that finding a strong sponsor is the key to the success or otherwise of the rehabilitation. Currently, it is generally either parent or affiliated companies that are intending to merge with the insolvent company or turn it into a subsidiary or group company, or major clients of the insolvent company who act as sponsors. However, we expect to see investment funds increasingly acting as sponsors, as happened with Fuji Kiko Denshi. These investment funds sponsor the rehabilitation of the insolvent company and hope to benefit from a consequent increase in the value of that company's shares (Table 2).

The company that agrees to sponsor the insolvent company is usually appointed to the position of trustee at the same time as the decision is made to go ahead with rehabilitation proceedings, and takes over the business of the insolvent company. If financing is required before rehabilitation plan begins, the sponsor can choose from various ways of raising finance: it can either lend directly to the insolvent company, discount notes of the company, underwrite a third-party share allocation, or negotiate with the main bank of the insolvent company, or other bank with which it regularly had dealings, for a new loan on condition that it is classified as a right of common interest. Under the Composition Law however, finding a sponsor company was often more difficult than rehabilitation of the company itself, causing many companies to have serious cash-flow difficulties.

Table 2 Recent Examples of Company Sponsors in Rehabilitation Proceedings

Date	Company being rehabilitated	Liabilities	Equity capital	Sponsor company	Remarks
Jan/97	Kyotaru (take-away sushi chain)	¥101.3 bn.	¥12.71 bn.	Katokichi (frozen food manufacturer)	In April 1999 Yoshinoya D&C also assisted by acting as a sponsor
Jun/97	Showa Denki Sangyo (electrical equipment wholesaler)	¥40.6 bn.	¥450 mn.	Takamizawa (construction materials manufacturer)	Takamizawa turned it into a 100% subsidiary
Jul/97	Tada Construction (construction general contractor)	¥171.4 bn.	¥4.1 bn.	Daioh Construction (construction general contractor)	
Aug/97	Daito Construction (Marine and land-based engineering	¥159.2 bn.	¥6.1 bn.	Nitto Construction (construction general contractor)	
Sept/97	Yaohan Japan (supermarket)	¥161.3 bn.	¥23.66 bn.	Jasco (supermarket)	
Dec/97	Toshoku (food trading company)	¥640 bn.	¥37.2 bn.	Toyota Tsusho (general trading company)	Nissin Food began transaction with Toshoku again and supported the rehabilitation
Feb/98	Fuji Kiko Denshi (printed board manufacturer)	¥17.61 bn.	¥76.8 mn.	Advantage Partners (investment fund)	The sponsor, Advantage Partners, is a non-Japanese investment fund, in which Marubeni also has a stake
Aug/98	Mita Kogyo (Photo-copier machine manufacturer）	¥205.7 bn.	¥3.33 bn.	Kyocera (semi-conductor components, communications devices etc.)	It was later discovered that the Mita Kogyo management had been falsifying the accounts

Source: NRI, from Teikoku Databank, "Corporate Bankruptcy Statistics (1998)" and the *Nihon Keizai Shimbun*

5. Reorganization of Bankrupt Companies and Financing of Insolvent Debtors in the U.S.

The financing of bankrupt debtors during reorganization type bankruptcy proceedings in the U.S. is fairly different from that in Japan. Reorganization type bankruptcy proceedings in the U.S. are handled under Chapter 11 of the Federal Bankruptcy Code.[7] In Chapter 11 bankruptcy, even subsequent to a filing of a petition for reorganization proceedings, the incumbent management may continue to operate the business as before and can manage and dispose of the company assets (estate). No trustee is appointed unless the incumbent management is either negligent or fraudulent. The company being reorganized is referred to as the "debtor in possession" or "DIP." However, in practice management is often changed during the course of the reorganization process.

[7] Incidentally, liquidation proceedings are contained in Chapter 7

The DIP needs to procure funds from somewhere in order to continue business operations after the filing of the petition for reorganization, but it is obviously more difficult for a company that has gone bankrupt to obtain credit as when it was healthy. Here Section 364 of the Federal Bankruptcy Code sets up conditions whereby the DIP may obtain credit, and by guaranteeing the lender it provides an incentive to lend to the DIP, so that the DIP may obtain credit relatively easily. The following four credit conditions are set out corresponding to the creditworthiness of the DIP:

(1) In order to continue with the normal course of business the DIP may obtain credit without needing to obtain the authorization of the court. Such debts are recognized as an administrative expenses (equivalent to rights of common-interest), and are assigned priority in repayment.

(2) If the DIP is not able to obtain unsecured credit recognized as an administrative expense, then subject to court authorization, it may take on debt that is of priority over any or all administrative expenses.

(3) If the DIP still cannot obtain credit, then subject to court authorization, it may obtain credit either secured by a lien on property of the estate that is not subject to a lien, or secured by a junior lien on property of the estate that is already subject to a lien.

(4) If the DIP still cannot obtain credit, then subject to court authorization, it may obtain credit by securing a lien on property of the estate that is of the same as or of priority than an existing lien. However the DIP must prove that the holder of the existing lien is adequately protected.

As secured debts are repaid at a higher priority than administrative expenses, then the degree of protection afforded the lender of the funds increases from (1) to (4) above. The lending of working capital to a DIP by a financial institution is termed “DIP financing,” and as this financing is generally for purposes outside normal business operations, it is normally obtained under conditions (2) to (4) above. In practice, it is more common for the lender to request a lien on property of the estate that is of higher priority than an existing lien.

In addition to these system incentives to the lender, it can expect higher margin and commission than it can achieve from regular lending, and also other fees related to its involvement in the reorganization of the debtor. In addition, it can expect to be able to continue financing the company after the reorganization of the company has been completed, and so there are many financial firms who engage in DIP financing. The main DIP lenders are banks, non-bank finance institutions and insurance companies. Chemical Bank (now Chase Manhattan Bank) earned a prominent reputation for providing this sort of finance, while such eminent institutions as Citibank, Wells Fargo and Bancamerica were also involved in financing reorganizations. Sometimes a syndicate for DIP lending is composed.

6. The Possibility of Introducing DIP Financing to Japan

The Reorganization Law clearly stipulates that claims arising from funds borrowed by the debtor can be treated as rights of common-interest, thus making it easier for debtors to obtain funds than was the case with the Composition Law, but regulations comparable to the U.S. regulations regarding DIP financing were not included. In other words, there is nothing in the Reorganization Law that equates to the ability in the U.S. to secure a lien on property of the estate that is of the same or higher priority than an existing lien on that property in order to make it easier to obtain DIP financing.

Leaving aside the question of the practicality of introducing such regulations in Japan, the new options of loan procurements by bankrupt firms will be useful to the reorganization of them. In order for DIP financing to be turned into a commercial activity, and indeed for the existing role of sponsor for insolvent reorganizing firms, the positive participation of Japan’s financial institutions is required.