

New option for out-of-court workouts for Japanese companies

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Speedread

In September 2009, the Enterprise Turnaround Initiative Corporation (ETIC) was launched, aiming to manage more complex workouts for companies where a higher level of initiative and more intensive use of professional expertise are required than cases filed with other out-of-court workout bodies. This article summarises the range of out-of-court workout options available, and explains key features of the service ETIC will provide.

For potential sponsors interested in investing in Japanese companies through their turnaround (restructuring) processes, having a variety of out-of-court workout procedures available is desirable. Since September 2009, the Enterprise Turnaround Initiative Corporation of Japan (ETIC) (*Kigyo-saisei Shien Kiko*) has added yet another method to options available for effecting such an investment.

Among the various types of out-of-court workout procedures the most popular in recent years have been:

Turnaround ADR (*Jigyo-saisei ADR*). This is an ADR procedure conducted by an organisation that is both:

certified by the Minister of Justice under the Act on Promotion of Use of Alternative Dispute Resolution; and

recognised by the Minister of Economy, Trade and Industry under the Act on Special Measures for Industrial Revitalisation and Industrial Innovation (formerly Act on Special Measures for Industrial Revitalisation).

Currently, the Japanese Association of Turnaround Professionals (JATP) (an association of turnaround practitioner lawyers, accountants, bankers and consultants) is the only organisation certified and recognised to conduct turnaround ADR procedures. The JATP commenced operations at the end of 2008 and six listed companies and one unlisted company have reportedly filed. These include, most recently, AIFUL Corporation (a major consumer loan firm) and WILLCOM Inc (a mobile telecommunications company).

Small and Medium Enterprise Turnaround Support Centres (*Chusyo-kigyo Saisei Shien Kyogikai*). These are local turnaround consulting service providers usually established by local chambers of commerce in each prefecture of Japan. Since starting operations in 2003, the Centres have provided consultation services to more than 18,000 companies and, by the

end of June 2009, had reportedly assisted with the completion of turnaround plans for more than 2,200 companies.

ETIC

The ETIC was established with the aim of managing more complex workouts for companies where a higher level of initiative and more intensive use of professional expertise are required than cases filed with a turnaround ADR or SME Turnaround Support Centres.

A company seeking support from ETIC must submit draft restructuring and revitalisation plans which have been negotiated with its main lending banks in advance. The ETIC will then:

Conduct due diligence on the company.

Conduct negotiations among the lending banks on debt restructuring and business restructuring.

Conducts talks with, and deal with bids made by, potential sponsors.

Clarify the responsibilities of management and shareholders.

Screen whether the restructuring and revitalisation plan will work, while also satisfying the criteria ETIC sets (once ETIC has decided to support buy out loans from the lending banks at discounted prices (and in some cases inject capital)).

Monitor implementation of the plan.

ETIC will exit any positions they have taken in the company by selling loans (and shares) that they have acquired or by other means.

The costs incurred by ETIC in supporting workouts (for example, the cost of buying loans from banks and injecting capital into target companies) will be funded by other banks or investors and supported by a government guarantee (the commitment for which being JPY1.6 trillion for the 2009 fiscal year).

These out-of-court workout procedures are characterised by transparency, neutrality of process and fairness (for example, proportionate discounts of purchase prices of loans). These are also features of court-sanctioned workout proceedings (that is, Civil Rehabilitation Proceedings and Corporate Reorganisation Proceedings), but have the advantage of being flexible and expedient.

Further, the filings and the commencement of the above procedures carry less of stigma than the filing and commencement of court-based proceedings. Also, unlike court-based proceedings, they usually do not automatically lead to acceleration of debt obligations owed by the company because of the way insolvency events of default are usually drafted.

The disadvantage of such procedures is that they require voluntary consents from all affected lenders for any debt restructurings, which may be difficult and costly to obtain.

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