

JATP REPORT

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Alternative Dispute Resolution Procedures for Turnaround of Business

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I. OVERVIEW

This memorandum outlines the basic features of the alternative dispute resolution procedures for turnaround of business (“Turnaround ADR¹”), which was established in 2008 by an amendment to the Act on Special Measures for Industrial Revitalization and Industrial Innovation in order to overcome some of the disadvantages² of out-of-court debt adjustments made pursuant to the *Guideline for Voluntary Debt Adjustment*³ and legal insolvency procedures under the Corporate Reorganization Act (Act No.154 of 2002) and the Civil Rehabilitation Act (Act No. 225 of 1999).

Pursuant to Turnaround ADR, a private sector entity certified as a “business resolution service provider” (*nintei funsou jigyo-sha*) by the Minister of Justice of Japan and the Minister of Economy, Trade and Industry of Japan provides mediation services. As of the date of this memorandum, the Japanese Association of Turnaround Professionals (“JATP”) is the only certified business resolution service provider for Turnaround ADR. The role of JATP is to provide a forum for Turnaround ADR, but JATP will not itself provide solution services in individual cases. Instead, a JATP committee selects candidates to serve as mediators (*tetsuduki jisshi-sha*, the “Mediators”) among turnaround professionals to mediate between a debtor and its creditors, facilitate an agreement between a debtor and its creditors with respect to a business rehabilitation plan, and prepare an expert opinion on the reasonableness and viability of such business rehabilitation plan

¹ Basic concepts and rules of Turnaround ADR are set forth in the Act on Promotion of Use of Alternative Dispute Resolution (Act No. 151 of 2004) and the Act on Special Measures for Industrial Revitalization and Industrial Innovation (Act No. 131 of 1999).

² Under bankruptcy procedures such as civil rehabilitation or corporate reorganization, payments to business partners are suspended and all claims are typically reduced, and therefore have an adverse effect on relationships with business partners. Further, it is disadvantageous for financial institutions to make bridge loans because they are not treated as preferred claims under the bankruptcy procedure if a company undergoes bankruptcy proceedings transferred from the procedures provided in the *Guideline for Voluntary Debt Adjustment*.

³ The *Guideline for Voluntary Debt Adjustment* was prepared by the Japanese Bankers Association and the Japan Business Federation (*Nippon Keidanren*). It sets forth voluntary procedures by which the debts of the debtor are reduced or waived according to a restructuring plan to which all participating financial institutions consent.

from a fair and neutral standpoint. The candidates selected by the JATP committee must be approved by a unanimous vote at the first creditors' meeting.

JATP, as a provider of Turnaround ADR, has issued specific rules for Turnaround ADR, to be amended from time to time. Every party involved in a Turnaround ADR case must proceed strictly in accordance with the rules, in addition to the regulations provided in the relevant laws and ministerial ordinances of the Minister of Economy, Trade and Industry of Japan.

II. ELIGIBILITY

Before a debtor initiates a Turnaround ADR, the debtor must first consult with JATP to determine whether or not it is eligible. Under the relevant laws and rules, there is no limitation on the size of an applicant, category of business of an applicant, or type of legal entity⁴ of an applicant. However, JATP will not allow a company to proceed with Turnaround ADR unless it concludes that there is a reasonable chance of a successful restructuring, and that the debtor is of adequate value to successfully participate in and complete the process. To successfully persuade JATP and candidate Mediators to grant eligibility for a Turnaround ADR, it is crucial for the debtor to complete intensive due diligence and form a well-organized business turnaround plan beforehand.

III. PROCEDURE OUTLINE

The procedure for Turnaround ADR is comprised of three stages: (1) the preliminary stage, (2) post-formal application and (3) post-voting of the business turnaround plan. See the "Chart of Turnaround ADR" attached hereto.

1. Preliminary Stage

Initially, a debtor that wishes to use Turnaround ADR will submit a preliminary application to be reviewed by the JATP committee. After receiving a preliminary application, the JATP committee selects two or three Mediator candidates from its list of eligible turnaround professionals to examine the eligibility of the debtor and the feasibility of the proposed plan. During the period between the preliminary application and the formal application, consultations among the debtor, its advisors and candidate Mediators continue. The length of the consultation period varies depending on the nature of the case, but may typically take at least a few weeks.

Before or during the consultation period, the debtor is required, at its own cost and expense, to conduct due diligence and a thorough assessment of its assets, prepare a modified balance sheet and liquidation balance sheet, and form a business plan indicating its projected operating profits and losses and a repayment plan, each of which is examined by the candidate Mediators. Further, the applicant is required to prepare a proposed business turnaround plan (*jigyousei keikaku*), which may be modified with the advice of the candidate Mediators. Based on the examination report by the candidate Mediators, JATP decides whether to accept or decline the official application. If JATP decides to accept the preliminary application, the debtor may submit a formal application to commence the Turnaround ADR.

⁴ Turnaround ADR is not available to individuals or to sole proprietorships.

2. Post-Formal Application

Upon acceptance of the formal application, the debtor and JATP jointly send a “Notice of Temporary Suspension” (*ichiji teishi tsuchi*) to each of the creditors who will participate in the procedure.⁵ The notice convenes a creditors’ meeting and may request, among other things, that the creditors do not accelerate loans, receive any payments or demand additional collateral from the applicant.⁶

Within two weeks of the date on which the notices of temporary suspension are distributed to all target creditors, the first creditors’ meeting is held. At the first meeting, the candidate Mediators are officially appointed as the Mediators and the effect of the notice of temporary suspension is approved by the creditors’ vote. The schedule for the case is also determined at the first meeting. Each resolution presented at a creditors’ meeting is validated only by a unanimous vote of the creditors present at such meeting. Further, at the first creditors’ meeting, the debtor will provide a summary of the proposed business turnaround plan to the creditors.

At the second creditors’ meeting, the finalized business turnaround plan is discussed among the parties. At such meeting, the Mediators present their expert opinion on the reasonableness and viability of the proposed plan.

At the third creditors’ meeting, the creditors vote for or against the proposed plan. Between each meeting, the Mediators coordinate among the interests of the creditors, examine the proposed plan in detail, and give various advices to the debtor concerning the proposed plan.

3. Post-Voting on the Business Turnaround Plan

In the event that all the creditors participating in the Turnaround ADR procedure consent to the proposed business turnaround plan at the third meeting, the business turnaround plan is validated, and the creditors’ rights are modified pursuant to the terms and conditions of the plan.

In order to validate the proposed plan, a unanimous vote of the creditors approving the plan is required. In the event that one or more creditors reject the proposed plan, the Turnaround ADR is immediately terminated. In such case, the debtor may go into another mediation process, known as Specified Conciliation proceedings (*Tokutei-Chotei tetsuduki*), filing a petition therefore with a competent court under the Act Concerning Specified Conciliation for Promotion of Settlement of Specified Debts, Etc. (Act No. 158 of 1999), pursuant to which a judge is reasonably expected to follow in the footsteps of the Turnaround ADR proceedings. If the debtor does not use the Specified Conciliation proceedings or the parties are unable to reach an amicable settlement pursuant to the Specified Conciliation proceedings, the debtor may immediately undergo legal insolvency proceedings, such as corporate reorganization under the Corporate Reorganization Act (Act

⁵ Turnaround ADR is designed primarily for creditors who are financial institutions, rather than suppliers or customers of the applicant company.

⁶ This notice is merely a request, and does not legally prohibit the creditors from accelerating loans or demanding that the applicant establish new collateral.

No.154 of 2002), or civil rehabilitation under the Civil Rehabilitation Act (Act No. 225 of 1999).

IV. MEDIATORS

After receiving a preliminary application, the JATP committee selects two or three candidates as Mediators. The number of Mediators varies depending on the nature of the case, however, at least three candidates are selected in the case of a COD type plan (as defined in Section VIII hereof). JATP has created a candidate list of Mediators, which will be amended from time to time, and the JATP committee selects, on a case by case basis, appropriate candidates from the list. Only expert professionals are included in the list, such as attorneys with considerable experience as trustees in past prominent corporate reorganization proceedings, certified public accountants experienced with the *Guideline for Voluntary Debt Adjustment*, and other advisors experienced in turnaround business. Generally, the selected Mediators for a given case consist of at least one attorney and one certified public accountant. Each of the Mediators may retain assistant attorneys or certified public accountants to support the Mediators' mission.

During the course of the Turnaround ADR, the Mediators coordinate among the interests of the creditors, examine the proposed plan in detail in order to prepare a written expert opinion to be presented at the second creditors' meeting, and give various advices to the debtor concerning the proposed plan. The Mediators often recommend modifications to the proposed plan as they deem necessary.

V. CREDITORS' MEETINGS

Turnaround ADR provides for three creditors' meetings throughout the procedure.

1. Participants

Each of the debtor, Mediators and creditors participate in every meeting. Which creditors should be included in a Turnaround ADR is a critical issue because complete attendance and a unanimous vote are required for every meeting and every resolution. Since Turnaround ADR strictly requires fair and equal treatment among the creditors of financial institutions, the debtor ordinarily calls all bank creditors having claims against the debtor to the first creditors' meeting by sending a notice of temporary suspension to each such bank creditor. However, it may sometimes be a thorny issue as to whether the debtor should also include large creditors other than banks into the Turnaround ADR process.⁷

⁷ While Turnaround ADR was designed mainly for "banks only," the relevant laws and ordinances and JATP's rules do not have any restrictions on the eligibility of other creditors. From the viewpoint of successful restructuring, the more support given by creditors, the higher the likelihood that the plan will be successful. However, since creditors such as non-bank financial companies, servicers, and leasing companies have different priorities and behavioral patterns from banks, debtors may be concerned about the possible negative impact (i.e. absence at the first meeting will trigger an immediate termination of the process) that may result from including such creditors into the Turnaround ADR.

2. First Creditors' Meeting

Within two weeks from the date the notices of temporary suspension are distributed to all target creditors, the debtor holds the first creditors' meeting to provide an outline of the proposed business turnaround plan to the creditors. The creditors' meeting is closed to the public and thus, only the target creditors who receive a notice of temporary suspension are permitted to attend the meeting. The absence of any one of the target creditors lacks a quorum. At the first creditors' meeting, the following items are determined by unanimous consent of the creditors:

- (1) Election of a chairman: ordinarily elected from among the candidate Mediators;
- (2) Appointment of the Mediators;
- (3) Terms and conditions of the temporary suspension;
- (4) Dates and locations of the upcoming creditors' meetings; and
- (5) (If planned) Preferential treatment for the Pre-DIP Financing.⁸

3. Second Creditors' Meeting

The second creditors' meeting is held to discuss the proposed business turnaround plan. By the date of the second meeting, the Mediators will prepare a written expert opinion (*chosa houkoku sho*) regarding the reasonableness and viability of the proposed plan⁹ after diligent examination and review of the proposed plan. At the second creditors' meeting, a summary of the expert opinion will be orally presented to the creditors. The proposed plan should generally be finalized at least several days before the second creditors' meeting because the Mediators' opinion will cover the plan on the assumption that it will not be amended. Normally, the debtor and each creditor exchange comments regarding the proposed plan to reach agreed-upon terms and conditions thereof. Such negotiation stage is concluded prior to the date of the second creditors' meeting.

4. Third Creditors' Meeting

During the period between the second creditors' meeting and the third creditors' meeting, each creditor will take the necessary steps to make an internal decision on the proposed plan. At the third creditors' meeting, the chairman will put the proposed plan to a vote. As explained previously, a unanimous vote is required for the resolution.

⁸ Bridge loans, usually referred to as "Pre-DIP financing" in Japan, provided to the debtor within the Turnaround ADR, may be treated preferentially to other ordinary claims in later civil rehabilitation proceedings or corporate reorganization proceedings if the court concludes, at its discretion, that certain criteria are met. Further, such Pre-DIP financing may be secured by a guaranty provided by the Organization for Small and Medium Enterprises and Regional Innovation, Japan.

⁹ In many cases, the Mediators' opinion is treated as material in the course of the bank's internal decision making process.

5. Adjournment

The relevant ordinance and rules of Turnaround ADR provide for three creditors' meeting. However, upon consent of the creditors, the number of meetings may be extended.¹⁰

VI. TEMPORARY SUSPENSION

1. Contents of the temporary suspension

A notice of temporary suspension, issued jointly by the debtor and JATP, is distributed to each target creditor upon or promptly after JATP's acceptance of the formal application of the debtor. The notice usually contains requests for voluntary restraint of i) any collection of claims, including but not limited to requests for repayment, offsetting or repossession, ii) creation of security interests and iii) involuntary petition for legal insolvency proceedings, such as bankruptcy, civil rehabilitation or corporate reorganization. Other specific requests may be made subject to the creditors' consent at the first creditors' meeting. Exceptions for temporary suspension may be enumerated in the notice in case such exceptions are deemed substantively fair.

2. Implication of the temporary suspension

Unlike a court order to suspend repayments rendered in legal insolvency proceedings, the requests for temporary suspension do not have a legally binding effect on creditors during the gap period between the date of notice and the first creditors' meeting. Once the creditors consent to the temporary suspension at the first creditors' meeting, it is generally understood that a temporary standstill agreement has been formed among the debtor and the creditors. Presently, there are no reports of any case where a creditor has ignored the temporary suspension in a Turnaround ADR case, even during the gap period. While there is no supporting court precedent, some leading experts suggest that the effect of the notices of temporary suspension are, as a legal matter, considered more persuasive than a mere entreaty from a private company due to the quasi-governmental nature of JATP, whose neutrality and expertise are legally guaranteed.

Since the *Guideline for Voluntary Debt Adjustment* was issued, it has been a controversial issue whether i) a request for temporary suspension falls within the definition of "suspension of payment" (*shiharai teishi*) as defined by insolvency laws, which is used as a cause for commencement of insolvency proceedings and as a threshold enabling a bankruptcy trustee to exercise his avoidance power on the debtor's preferential action¹¹. ii) a request for temporary suspension triggers an acceleration event on the basis that such request may be construed as an event of credit insecurity typically stipulated in the catch-all clause in standard loan agreements.

¹⁰ In the case of Cosmos Initia Co., Ltd, five creditors' meetings were held with the consent of the creditors.

¹¹ In Japanese insolvency laws, a certain category of preferential actions taken by a debtor before the petition may be avoidable by the bankruptcy trustee if such action is taken after the debtor's status becomes insolvent. The status of insolvent shall be presumed in case the debtor takes an action being construed as "suspension of payment," (e.g. Paragraph 3 and Paragraph 1, Article 162 of the Bankruptcy Law.)

VII. DISCLOSURE

Since the Turnaround ADR process is not open to the public, no information concerning the Turnaround ADR may be disclosed to the public, particularly when the debtor is a non-public company. In the event the debtor is a public company, timely disclosure in accordance with the rules of the relevant stock exchange may be required. However, the timing of public disclosure with respect to a Turnaround ADR is not clear. For example, it may be argued that a preliminary application does not trigger a disclosure requirement under the rules of the Tokyo Stock Exchange (the “TSE”). Disclosure may be required if a formal application is accepted by JATP or if notices of temporary suspension are sent to the creditors. Further, if a business turnaround plan contains cancellation of debts, then such plan contains “financial support.” In such a case, the approval of a business turnaround plan with financial support at a creditors’ meeting would trigger the timely disclosure requirement under the TSE rules. In actual cases, most public company debtors¹² released press releases at the time of JATP’s acceptance of its formal application and subsequently released summary reports of each creditors’ meeting. The information contained in the press releases varies case by case.

VIII. BUSINESS TURNAROUND PLAN

In a Turnaround ADR case, the debtor will, with assistance from its professional advisors, prepare a business turnaround plan based on the results of self-conducted due diligence and asset evaluation. The debtor will proceed with the Turnaround ADR steps in order to have the business turnaround plan approved by its creditors. While the terms and conditions of a business turnaround plan vary from case to case, the relevant ordinances and rules classify business turnaround plans into two types: i) the rescheduling of debt type (the “ROD type”) and ii) the cancellation of debt type (the “COD type”). Turnaround ADR puts a heavier burden on a debtor which envisions a COD type plan than a debtor of a ROD type plan.

1. Plan of the ROD type

Pursuant to the rules of Turnaround ADR, the following eight items are required for a business turnaround plan: i) the reasons for the debtor’s financial difficulties, ii) the measures for business restructuring, iii) the measures for strengthening the capital base, iv) the projections of assets and liabilities, and profits and losses as a result of the business turnaround, v) the plans for raising funds, vi) the repayment plan, vii) the modifications of the creditors’ claims and rights and viii) the projected amount of claims to be collected by the creditors pursuant to the business turnaround.

2. Plan of the COD type

For debtors under a COD type plan, the rules require the following five additional items to be included in the proposed business turnaround plan: i) a modified balance sheet prepared based on the values of assets assessed in the self

¹² See the websites of Cosmos Initia Co. Ltd., Japan Asia Investment Co., Ltd., Saikaya Co., Ltd, Radia Holdings Inc., ES-CON Japan Ltd., Aiful Corporation, and Japan Airlines Corporation (as of December 2009).

assessment process, which must strictly comply with the rules of the ordinance of the Minister of Economy, Trade and Industry of Japan¹³, ii) the amount of cancelled debts, calculated based on the values of the assets and liabilities stated in the modified balance sheet mentioned in item i) above of this paragraph and the projected profits and losses stated in the business turnaround plan, iii) the extinction of all or part of the existing shareholders' rights, iv) the resignation of the existing board members (except for cases where the resignation of the board members will significantly undermine the going-concern basis of the debtor), and v) the cancellation of debts from two or more creditors of financial institutions OR one or more government-affiliated financial institutions¹⁴¹⁵.

IX. TIME FRAME

JATP anticipates that a Turnaround ADR will take approximately three months from the date of the notice of temporary suspension to the date of approval of the proposed plan. Compared with other legal insolvency proceedings, such as civil rehabilitation proceedings which normally take around 6 months from filing of the petition to the approval of a civil rehabilitation plan, a Turnaround ADR is expected to be a more expedient process, which is advantageous for the debtor. Please note, however, that this time frame excludes the preparation period for the Turnaround ADR. The length of time necessary for adequate preparation will vary depending on the complexity of each case.

X. COSTS

According to JATP, the initial fee charged for a preliminary application is 500,000 yen (excluding consumption tax). Additional fees are charged upon i) JATP's acceptance of the preliminary application, ii) the formal application and iii) the resolution of the proposed plan. The amounts of such additional fees are determined by JATP, taking into consideration the number of creditors, the amount of debt and the nature of the case. In addition, the debtor will incur the fees of its professional advisors, such as legal counsel, accountants, and tax and financial advisors retained for due diligence, asset evaluation and preparation of the proposed business turnaround plan.

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¹³ “Standard for the Asset Assessment to be Conducted pursuant to Paragraph 1, Article 14 of the Ordinance concerning Certification of Business Resolution Service Provider in connection with the Business Turnaround, etc.” effective as of November 20, 2008.

¹⁴ Creditors that waive or reduce their claims pursuant to the business turnaround plan are eligible for certain tax advantages, such as being permitted to declare the waived or reduced amount as tax losses.

¹⁵ There are certain tax advantages for the debtor, including, but not limited to, the debtor's option to declare as a tax loss the difference between the value of assets assessed in the modified balance sheet and the book values of the assets in order to avoid the COD income tax.

Chart of Turnaround ADR

