A Look Into Recent Maritime Insolvency Cases in Japan

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I. Brief summary of Japanese insolvency laws

Japan has three types of insolvency proceedings: (1) bankruptcy proceedings under the Bankruptcy Act; (2) civil rehabilitation proceedings under the Civil Rehabilitation Act; and (3) corporate reorganization proceedings under the Corporate Reorganization Act. The proceedings under the Bankruptcy Act is basically procedure for the liquidation of the bankrupt's assets as managed by the court appointed trustee.

The process under the Civil Rehabilitation Act is the most popular tool to rehabilitate the distressed companies. This is basically a debtor in possession type procedure akin to proceedings under Chapter 11 of the United States Bankruptcy Code. This proceeding deals with the restructuring of only the debts

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owed to unsecured creditors while leaving secured creditors free to enforce their rights over collateral pledged by the debtor. The Tokyo District Court has established a "standard schedule for proceedings" under which civil rehabilitation proceedings should be terminated within six months from commencement as a goal. In practice however, there are often complicated cases which go beyond the target six months for completion.

The process under the Corporate Reorganization Act dealing with both secured and unsecured creditors, unlike civil rehabilitation proceedings which only deal with secured creditors. Also unlike civil rehabilitation proceedings, in corporate reorganization proceedings, the management of the business is taken over by a court appointed trustee, who will normally be a capable insolvency lawyer. Because these proceedings usually more involved, they usually take more time to complete than civil rehabilitation proceedings. As such, the standard schedule for completion established with respect to corporate reorganization is set at nine months as the goal for completion.

II. Analysis of Insolvency Cases regarding Japanese Shipping Industry

While there seems to be a number of restructuring cases among shipping companies in Japan it is likely that a large proportion of these have been resolved through out of court workouts, rather than through one of three court supervised procedures discussed above. One of the reasons that the shipping companies may prefer restructuring through an out of court workout is that many of them may have pledged ships owned by the company (directly or through a special purpose company) as collateral to large creditors such as lender banks. Upon becoming distressed due to market turmoil, a shipping company would naturally wish to sell its ships even at a low price to obtain cash necessary to maintain business operations and to pay back loans; however, lenders may prefer to extend the loan term under the out of court workout, without using hair cuts (debt forgiveness) and wait for the recovery of the market to sell the ships at the higher price enough to pay back the loan (and its interest) fully.

There are several cases where shipping companies filed for the above legal insolvency procedure after 2000: Arimura Sangyo Co., Ltd. in 2008, DORVAL KAIUN K.K in 2011, the Sanko Steam Ship Co.,Ltd in 2012, , DAIICHI CHUO KISEN KAISHA in 2015, Rams Corporation in 2015. As shall be examined in further detail below, although reasons for the insolvency filings were similar, the restructuring plans for each case needed to be fitted to the unique features of each case and the issues that arose in each case.

III. Sanko Steam Ship Co., Ltd. (2012)[1]

Facts

Sanko Steam Ship Co., Ltd. ("Sanko") filed for Japan's Business Restructuring ADR procedure on May 15, 2012. The Business Restructuring ADR process is an out-of-court procedure, which is very similar to the process under the "Insol 8 principals" and/or so called "London Approach." Under these proceedings the debtor and financial creditors negotiate the restructuring plan of the debtor out of court. The restructuring plan should be approved unanimously by the creditors. Sanko, however, abandoned its attempts to obtain unanimous approval and proceeded to file for in-court proceedings under the Corporate Reorganization Act on July 2, 2012. The commencement order was granted on July 23, 2012 and the proceedings were completed on December 2, 2014. This was the second time that Sanko had experienced insolvency proceedings, having filed for corporate reorganization proceedings earlier in 1985 which were completed in 1998[2].

Reasons for insolvency

The reasons for Sanko's insolvency in 2012 was "negative carry" where the freight and charterage paid to the company fell dramatically and payments to the owners of borrowed ships became very expensive. Sanko was unable to acquire enough cash to continue operations even by selling ships that it owned because the price of ships continued to fall sharply. Sanko's attempt at an out of court workout (Business restructuring ADR) ultimately failed because it was unable to obtain unanimous consent for its rehabilitation plan after it business continue to fail following the arrest of ships used in the business by two foreign ship owners.

Key Features of Restructuring

1. Insolvency proceedings may prevail over attachment against the ship

Under the Uncitral Model Act (Art.20) as well as Chapter 15 of the Bankruptcy Code of the United States, all execution processes against the debtor and disposal of the debtor's assets should be suspended once a foreign insolvency proceeding is recognized by the relevant (bankruptcy) court. The Sanko case may illustrate the tension between the maritime proceedings and bankruptcy proceedings.

During the Japanese ADR proceeding, the foreign owners of the ship

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[1] See "Draft Plan of Reorganization" of Sanko, which was issued July 31, 2013.

[2] See Yasuo Harada, " Examples of Reorganizations in the Biggest International Cross Border Insolvency Cases," Kinyuhomu Jijo No.1367, 61(1993)

Sanko Mineral, commenced "Rule B attachment (the Supplemental Rules for Certain Admiralty Procedures and Claims)" proceedings under the U.S. Federal Rules of Civil Procedure in the United States District Court of the District of Maryland ("MDD Court"). Then the ship was arrested under the "Rule C arrest" mechanism by way of maritime lien of charterers. Sanko subsequently filed for insolvency proceedings in Japan and filed for Chapter 15 proceedings with the United States Bankruptcy Court for the Southern District of New York and also filed a request in the MDD Court to vacate the Rule B attachment. The MDD Court granted this request and revoked the Rule B attachment before the U.S. bankruptcy court ordered recognition of the Japanese insolvency procedure[34].

2. Unique feature of payment plan in the reorganization plan[5]

The reorganization plan for Sanko in the Japanese corporate reorganization proceedings included a special payment arrangement for secured creditors (banks), to whom the ships had been pledged as collateral. While the amount of secured debt should be determined at a fixed price in the plan, the amount to be secured would be determined depending on the sale price of the ship. For example if the amount of the secured claim is USD 100 and the collateral (ship) is sold at the price of USD 70, then the secured claim would be adjusted to USD 70 and USD 30 would be allocated to unsecured claims. This arrangement was very convenient both for Sanko as debtor as well as its secured creditors because it took away the need to fight over the amount of secured claims in the process of determining the amount of creditor claims.

3. Ship auction under the Judicial Sale and Tender Process (Hong Kong)[6]

The Sanko reorganization plan provided that the secured creditors (banks) were entitled to sell the collaterized ships by auction. The secured creditors decided to sell the ships not in Japan but in Hong Kong (The High Court of the Hong Kong Special Administrative Region). The reason for selling in Hong Kong was that: (1) the price that could be obtained for the sale of ships by auctions in Japan tended not to be very high; and (2) it was uncertain whether the ship would be free of security interests and liens, especially maritime liens upon an auction sale in Japan where precedent for such circumstances were lacking, whereas, in Hong Kong, the courts can order that the purchaser of a ship in an auction process can acquire ownership free and clear of maritime

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[3] Evridiki Nauvifation Inc. v The Sanko Steamship Co. 880 E. Supp. 2d 666 (D. Md. 2012).

[4] See Eijo Yamahara, "the 11the story: Vingt mille lieues sous les mers," NBL No.982 124 (2012), Fumiko Masuda, "Competition Between Insolvency Proceedings and Maritime Proceedings," Kaihokaishidfukkan No.59 46 (2016).

[5] See supra note 1

[6] See Wakabayashi=Suga "Ship Auction Process under the Corporate Reorganization Plan at a foreign country" NBL No.1060 31(2015)

liens, other charges and encumbrances. In addition, orders of the Hong Kong court had the reputation of being honored outside of Hong Kong and by secured creditors generally.

4. Arbitration related issue[7]

The Sanko case also involved an arbitration, the seat of which was in London. The Tokyo District Court[8] made a significant ruling with respect to the arbitration. The plaintiff, a ship owner chartered to Sanko, alleged that the charterage of a ship should be a common claim under the Corporate Reorganization Act and should be paid immediately. Under the Corporate Reorganization Act, common claims should be paid outside the reorganization proceeding and the plan. Sanko as defendant argued that the issue should be resolved through arbitration. The Tokyo District Court ordered that the court, not the arbitral tribunal, should decide upon whether or not the alleged claims were in the category of common claims because: (1) the issue concerned a matter that should be interpreted by reference to the Japanese Corporate Reorganization Act which the London arbitral tribunal might have difficulty interpreting; and (2) the application for arbitration should not be allowed by a party who filed for insolvency proceedings under the English law. The court's reasoning was that the issue regarding the category of the claims was not a matter that could be appropriately determined through arbitration as a private matter. In other words, whether a claim should be considered a common claim under the Corporate Reorganization Act was an issue for the court, not the parties to decide[9].

IV. Rams Corporation (2015)[10]

Facts

A bank filed for involuntary insolvency proceedings against Rams Corporation ("Rams") under the Corporate Reorganization Act on November 11, 2015 and the court granted the commencement order on December 31, 2015.

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[7] See Naoshi Takasugi, "Effect of Arbitration Agreement in relation to dispute over common claims in the Insolvency Proceedings" Jurist No.1493 114 (2016), Hiroyuki Teduka, "International Arbitration and Foreign Insolvency proceedings" International Arbitration and Corporate Strategy 474 (2014)

[8] See Tokyo District Court Heisei 24(wa) No.35587 (January 28, 2015)

[9] One important issue between arbitration and insolvency proceedings is whether the debtor would be bound to the arbitral award. This is an issue that arises when the amount of claims is determined as the debtor (trustee) goes through the process of confirming the filed claims from creditors. See Makoto Ito, Bankruptcy Act/Civil Rehabilitation Act (3rd Edition) 632 (2014)

[10] See Shinji=Asada=Horimoto=Asano=Takahashi=Isimori, "Corporate Reorganization Case of Rams Corporation," Jigyosaisei to Saikenkanri No.159 94 (2018)

In addition to Rams, fillings were made against 38 subsidiaries of Rams registered either in Singapore or Panama, each of which subsidiaries were set up as special purpose companies to own a ship[11]. These subsidiaries borrowed from banks to buy the ships, pledging the ships as collateral and with Rams being jointly liable as guarantor of the loans. Rams's only income was from the charterage of these ships.

Reasons for insolvency

Certain terms and conditions including the charter term and charterage in the charter contracts submitted by Rams to the banks in connection with obtaining the loan were false. This submission of false information constituted an event of default under the loan documents and consequently, once the default was discovered, the bank filed involuntary insolvency proceeding against Rams.

Key Features of Restructuring

1. 100% payment to trade creditors[12]

Rams lacked the funds to carry on the business. However it was necessary for the company to pay 100% amount of its trade claims to continue its business in the usual course. Rams asked the banks at which its special purpose subsidiaries had deposits to release a part of the deposits. The procedure for the release included the following steps: (1) the banks suspended the set off between the deposits and its claims; (2) the banks upon taking a pledge over the deposits then permitted the special purpose subsidiaries to release part of the pledge in an aggregate amount corresponding to the amount needed by Rams to continue to operate the business. This method was beneficial to Rams as debtor, but also to its trade creditors and banks. As a result, Rams management was able to maintain its business and rehabilitate itself without deterioration to corporate value. The trade creditors were paid in full and continued business with the debtor. The banks were able to monitor the company to rehabilitate and increase the possibility of repayment in due course according to the plan.

2. Two methods for disposal of the ships[13]

The reorganization plan in the Rams case included two types of treatment for the disposal of a ship owned by a special purpose subsidiary.

Under the reorganization plan, short term ships (generally, ships having a charter term of only a few months), were to be sold off by auction by each special purpose subsidiary owning a ship, after which each such special purpose

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[11] The practice of setting up a special purpose company to own each ship is to minimize the risk of vessel arrest in the event of defaults; see Fumiko Masuda, "Ship Finance/Cross Boarder Insolvency" Kaihokaishidfukkan No.58 104 (2015).

[12] See the supra note10 99.

[13] See the supra note10 103.

subsidiary would be liquidated. Where the trustee was not entitled to execute an auction in a jurisdiction outside Japan, the trustee would ask the secured creditors (banks) to execute their mortgages against the ship.

In the case of long term ships (generally, ships with a charter term of more than a year), these would be handled by either selling each special purpose subsidiaries owning a long term ship by way of a share transfer to a specific purchaser, or by having such subsidiary sell the ship to the specific purchaser.

3. Payment arrangement for secured creditors[14]

The payment arrangement for secured creditors under the reorganization plan was similar to that applied in the Sanko case discussed above. The secured creditors who had security interests over the charterage receivables, including future receivables, were treated the same way as creditors to whom the ships were pledged as collateral. An issue was that the trustee might have difficulty calculating the future amount of charterage receivables and the secured creditors might object if the trustee decided upon a fixed price. Under this arrangement the secured creditors would be paid the amount of money from charterage paid to Rams regularly after deducting operating costs of the company. This payment arrangement was beneficial to both sides. Rams was able to use part of the charterage to maintain the business and rehabilitate itself. At the same time, payments to secured creditors were continued until either the relevant claim was paid in full or the charter was terminated.

4. Applying Japanese Corporate Reorganization Proceedings to Non-Japanese Entities[15]

A question one might ask is how the foreign subsidiaries of Rams were included in the Japanese proceedings. The Japanese Corporate Reorganization Act allows a petitioner to file insolvency proceeding with respect to a stock corporation. The question faced by the Tokyo District Court in this case was whether the foreign corporations could qualify as "stock corporations" for the purposes of the Japanese Corporate Reorganization Act. In examining this issue, the Tokyo District Court examined the similarities between the foreign subsidiaries and Japanese stock corporations, looking at factors such as: (1) whether the equity holder's liabilities in respect of the entity would be limited to the capital investment; and (2) whether the equity holders and persons who executed the business of the entity were separate from each other under the structure of the subsidiaries.

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[14] See the supra note10 123.

[15] See the supra note10 111.

V. DAIICHI CHUO KISEN KAISHA(2015)[16]

Facts

DAIICHI CHUO KISEN KAISHA ("Daichi") filed for insolvency proceedings under the Civil Rehabilitation Act on September 29, 2015. The court granted the commencement order on October 5, 2015 and the proceedings were completed on August 31, 2016.

Reasons for filing

The reason for Daichi's insolvency was "negative carry" as experienced by Sanko. Upon falling into difficulty, Daichi hoped to cancel its charter party as executory contracts under the Civil Rehabilitation Act. A major reason for selecting civil rehabilitation proceedings over corporate reorganization proceedings was the expected length of time for completing the proceedings. As discussed above, the practice standard for completing civil rehabilitation proceedings is shorter than for corporate reorganization proceedings.

Key Features of Restructuring

1. Executory contract regarding the charter party

As mentioned above, executory contracts can be cancelled under Japanese insolvency laws[17], similar to the approach taken under the Bankruptcy Code of the United States[18].

2. Several arrangements to pay the claims of trade creditors

To fully pay the claims of trade creditors is critical for a debtor to be able to continue its business even after the filing for insolvency proceedings. In similar cases, usually a debtor will seek interim measures from the court for the purpose of obtaining relief during the period between the filing for insolvency proceeding and the time that the commencement order is granted[19]. However this sometimes hinders payment to trade creditors which causes suspension of transactions and the business of the debtor. Therefore, Daichi sought permission from the court in advance to allow payments related to administration of its maritime business.

Subsequently, Daichi sought recognition orders from six important jurisdictions for its business: the United States, Canada, Australia, South Africa, England and South Korea. Obtaining recognition from other jurisdictions has

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[16] See Fukuoka=Sugano=Fuji, "Civil Rehabilitation case of DAIICHI CHUO KISEN," Jigyosaisei to Saikenkanri No.156 124 (2017).

[17] See Article 49 of the Civil Rehabilitation Act, Article 61 of the Corporate Reorganization Act, and Article 53 of the Bankruptcy Act.

[18] Article 365 of the United States Bankruptcy Code.

[19] Article 26 of the Civil Rehabilitation Act.

become common practice for cross border insolvency cases in Japan.

3. Interaction between the confirmation of creditors' claims and litigation outside Japan[20]

At the time Daichi filed for civil rehabilitation proceedings in Japan, it was also involved in a case in the UK courts regarding a claim for damages arising from a maritime accident. By then, the matter progressed all the way to the UK Supreme Court. The issue that arose was whether the claim confirmation process would be continued in the Japanese court before the UK Supreme Court decision was rendered or whether the Japanese proceedings should be suspended until the case before the UK Supreme Court was completed. When Daichi sought recognition in the UK for the Japanese civil rehabilitation proceedings, Daichi was presented with the condition that it consent to the recommencement of the UK Supreme Court case, in order for the recognition of the Japanese proceedings to be granted. Daichi chose to accept the condition. Accordingly, the claim confirmation process in Japan was suspended until the UK Supreme Court reached its judgement.

VI. Dorval Kaiun K.K.[21]

Facts

Dorval Kaiun K.K. ("Dorval") filed for insolvency proceedings under the Civil Rehabilitation Act on December 2, 2012. The commencement order was granted on December 8, 2011 and the court's confirmation of the rehabilitation plan was obtained on June 13, 2012.

Reasons for filing

Dorval bought new ships during the 'ship bubble era,' which began from 2003. The era was ended by the Lehman Crisis in 2008. The resulting economic downturn created a situation in the ship industry where there were an excessive number of ships compared to the demand. As orders fell, the number of freights also fell creating a dire situation for Dorval. Dorval attempted to respond to the situation by selling its ships; however, it had to sell at very low prices, thereby being insufficient to stop the deterioration in its cash flow situation.

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[20] See supra 16 135.

[21] See Hiroaki Yoshida, "A Civil Rehabilitation Case in which Business Resources Were Reconstituted Following a Business Reset" Jigyousaisei to Saikenkanri No.138 172 (2012))

Key Features of Restructuring

1. Unique feature of the rehabilitation plan

The rehabilitation plan in the Dorval case was *quasi* (or *subrosa*) "liquidation plan." As the plan for Dorval was being drawn up, it took into consideration the situation that Dorval's ships would soon be attached by maritime liens and that it would be unlikelty that Dorval would be able to continue business under its circumstances. The only valuable asset of the company was brand name "Dorval" accordingly, a plan was developed to first sell off the company's ships and other tangible assets with the help its secured creditors and then sell the brand name Dorval and the company's intangible assets such as knowhow and network relationships to a specific buyer. In order to achieve this, Dorval terminated its employees and negotiated for their agreement to work with the buyer. This is very unique plan under civil rehabilitation proceedings.

VII. Arimura Sangyo Co., Ltd. (2008) [22]

Facts

Arimura Sangyo Co., Ltd. ("Arimura") filed for insolvency proceeding under the Corporate Reorganization Act in 1999. The corporate reorganization proceedings were terminated and moved to liquidation proceedings under the Bankruptcy Act in 2008.

Key Features of Restructuring

1. Reason of moving from corporate reorganization proceedings (rehabilitation) to bankruptcy proceedings (liquidation).

The reason Arimura moved to liquidation proceedings from the reorganization proceedings related to its executory contracts with respect to its charter parties. The trustee assumed the charter parties so that Arimura could to continue its business; however, as a result, this made the charterage a common claim. Common claims must be paid in full outside the corporate reorganization proceedings. As consequence of having to pay the full amount of the charterage and Arimura was left with insufficient cash for operating the business. Cash shortage is a common cause of rehabilitating companies to falling into liquidation proceedings under the Japanese Bankruptcy Act.

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[22] See Yosiaki Toshi, "Case of Insolvency Disposal of a Ship Company" Jigyousaisei to Saikenkanri No.137 198 (2012)

VIII. Advantages for Debtors Under Japanese Proceedings

Two important tools for the survival of a legally insolvent company in Japan are: Ipso Facto Clauses and Executory Contracts.

Agreements including charter parties between a distressed company and the ship owner or charter party inevitably includes ipso facto clauses, which provide that the agreements will become null and void once a party files for an insolvency proceeding[23].

However the Supreme Court of Japan has ruled that ipso facto clauses are void because such clauses, if permitted, would destroy any attempt for a debtor company to rehabilitate itself, which would be contrary to the aims of Japanese insolvency law, especially the Corporate Reorganization Act and the Civil Rehabilitation Act[24]. On the other hand, the debtors are permitted to decide to continue profitable businesses and reject not-profitable businesses by way of executing executory contacts with trade creditors under the Japanese insolvency laws[25][26].

These two tools provide strong support for insolvent companies to maintain profitable relationships and rehabilitate themselves.

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[23] See Reiko Yoshida, "Protection of Ship Finance Claim from Insolvency proceedings" NBL No.1023 24 (2014)

[24] Decision of the Third Petty Bench of the Supreme Court of Japan, July 30, 1982; Decision of the Third Petty Bench of the Supreme Court of Japan, December 16, 2008.

[25] See supra note 17.

[26] However some argue that the bare charter party should be treated as finance lease, not an executory contract. If this is the case, a finance lease should be treated as a secured claim, which enjoys priority under the insolvency procedures; see Shibakawa=Miyagi, "Treatment of bare charter party at the time of chaterer's insolvency" Kaijihokenkyukaishi No.208 2 (2010)

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