

**Insolvency Law Responses to a National Crisis:  
Great East Japan Earthquake  
and Guidelines for Individual Debtor Out-of-Court Workouts**

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\* The authors wish to acknowledge the untold hardships faced by victims of recent events in Japan and offer our sympathies to those who lost family and friends to the disasters.

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## I. INTRODUCTION: GREAT EAST JAPAN EARTHQUAKE AND PERSONAL INSOLVENCIES

This article presents the first detailed English-language analysis of the Guidelines for Individual Debtor Out-of-Court Workouts ('Guidelines')<sup>1</sup> and complements a tentative translation of the original Japanese version translated into English by the authors.<sup>2</sup> The Great East Japan Earthquake and its devastating aftermath increased scrutiny on many aspects of Japanese society. Macro questions about civil society, such as who should pay for natural and human-made disasters and whether it is viable to rebuild crippled communities and infrastructure, are at the forefront of academic, media and policy-maker debates. At the same time, there are many issues at the micro level, including the mechanisms available to deal with individual financial hardship. The so-called 'double loan crisis', where disaster victims have been struck by the double hardship of having to pay out existing loans whilst seeking new finance to rebuild lives, businesses and homes, was the immediate catalyst for the creation of the Guidelines in 2011.

This article also examines the drivers and stakeholders which led to the Guidelines' creation, and argues that their limited success is not just due to a failure in public relations. The government estimated that up to 20,000 people might be eligible for the Guidelines.<sup>3</sup> At the time of writing, very few people have benefited from the Guidelines, but the reconstruction effort will take decades and the lack of initial use has already led to minor adjustments.<sup>4</sup> Finally, the article examines the current status and operation of the guidelines and argues that these types of informal mechanisms have an important role to play in a functioning insolvency regime, broadly defined.

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1 *Kojin saimu-sha no shiteki seiri ni kansuru gaidorain*, available at <http://www.kgl.or.jp/guideline> (last retrieved on 23 June 2012).

2 The English translation of the Guidelines is available at <http://www.kgl.or.jp/guideline/pdf/guideline2.pdf> (last retrieved on 23 July 2012).

3 S. JIMI, Minister for Financial Services, Press Conference (23 August 2011), Financial Services Agency, available at <http://www.fsa.go.jp/en/conference/minister/2011/20110823.html> (last retrieved on 23 June 2012). The Minister's estimate was based on consultations with financial institutions in the three most affected prefectures (Iwate, Miyagi and Fukushima). The government found that there were an estimated 18,000 debtors who had suspended repayments on existing loans.

4 The Guidelines have been amended in practice, as discussed below. See the Guidelines homepage, available at <http://www.kgl.or.jp>. See more 'Shishin no yōken kanwa-tō motomeru shūin-i de ōguchi-shi' [Oguchi seeks mitigation of the Guideline Requirements in a Committee of the House of Representatives], *Komei Shinbun*, 26 October 2011, available at [http://www.komei.or.jp/news/detail/20111026\\_6461](http://www.komei.or.jp/news/detail/20111026_6461) (last retrieved on 23 June 2012).

## II. BACKGROUND TO THE DRAFTING AND ESTABLISHMENT OF THE GUIDELINES

### 1. *Double loan crisis and stakeholder responses*

The Guidelines are part of the Japanese government's response to the so-called 'double loan crisis' and are designed to help individuals (*kojin*) overcome financial hardship in circumstances where they have lost machines, factories and residential houses as a result of the disaster.<sup>5</sup> Immediately after the disaster, the Japanese government strongly suggested to financial institutions and other lenders that they consider giving payment and term relief to disaster victims suffering from financial hardship as a result of the disaster, in particular in relation to individuals with residential home loans and individuals operating businesses who borrowed money in connection with those enterprises. According to the Financial Services Agency ('FSA'), approximately 7500 people postponed payment on their loans between March and the end of June 2011 in the three main affected prefectures of Iwata, Miyazaki and Fukushima on an informal and ad hoc basis. The government was concerned, however, about the impact of financial institutions starting to ask borrowers to commence repayments again and the impact on potential reconstruction of the 'double loan crisis' (also translated as the 'overlapping debt problem').<sup>6</sup> The FSA was instructed by the government to find ways to assist such debtors.<sup>7</sup>

The Japanese government announced the 'Double Loan Problem Action Plan' on 17 June 2011. The Guidelines were one of the key elements of the plan. In July 2011, in accordance with the government's plan, the Research Committee for the Guidelines (*Kojin saimu-sha no shiteki seiri ni kansuru gaidorain kenkyū-kai*) was established. The Japanese Bankers Association was secretariat and Shinjiro Takagi (former Chair of the Industrial Revitalization Committee) was chair. The group included representatives from finance, commerce and industry, legal and accounting experts and experienced academics. It was also joined by members of the FSA, Supreme Court of Japan, Ministry of Justice, Ministry of Economy, Trade and Industry, Bank of Japan and others as observers. The FSA co-operated with all of the parties and liaised with the various government agencies such as the National Tax Agency of Japan to ensure their support for the

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5 *Kojin saimu-sha no shiteki seiri ni kansuru gaidorain Q&A Q.2* [Guidelines for Individual Debtor Out-of-Court Workouts Q&A], available at <http://www.kgl.or.jp/guideline/pdf/qa.pdf> (last retrieved on 23 June 2012); N. KOBAYASHI, *Kojin saimu-sha no shiteki seiri ni kansuru gaidorain no gaiyō* [Summary of guidelines for individual debt workouts], in: *New Business Law* 962 (2011) 29, 48; *Jūtaku rōn menjo no jōken kanwa hisai-sha taishō* [Housing loan exemptions aim to relieve burdens on earthquake victims], *Asahi Shinbun*, 25 October 2011, available at <http://www.asahi.com/special/10005/TKY201110240647.html> (last retrieved on 23 June 2012); S. FUKUOKA, *Ugoki hajimeta 'kojin-ban shiteki seiri gaidorain'* ['Individual Workout Guidelines' start to get going], in: *Hō to keizai no jānarū* [Journal of Law and Economics], 30 September 2011.

6 *Supra* note 5; KOBAYASHI, *supra* note 5, 48; ASAHI SHINBUN, *supra* note 5.

7 JIMI, *supra* note 3.

Guidelines. On 15 July 2011, the Research Committee released the Guidelines and a detailed fact sheet ('Q&A') was released later that month.<sup>8</sup>

The Guidelines were pulled together very quickly and commenced operation on 22 August 2011, but they build on other established out-of-court procedures in Japan dealing with corporate insolvency, including the Guidelines for Multi-Creditor Out-of-Court Workouts ('Corporate Guidelines')<sup>9</sup> (September 2001),<sup>10</sup> and the operation of Japan's Industrial Revitalization Commission (May 2003)<sup>11</sup> and the Enterprise Revitalisation ADR Procedure (2007).<sup>12</sup> Many of the entities and individuals involved in drafting the Corporate Guidelines were part of the Research Committee which worked on the Guidelines.<sup>13</sup> The procedure and wording of the Guidelines are closely based on the

8 *Supra* note 5.

9 The Japanese title and authors' translation of the Guidelines emphasize that they are an informal workout procedure focused on individuals, drawing a direct distinction from the existing informal guidelines which focused on corporations. We have not adopted the term 'multi-creditor'. Even in the case of the Corporate Guidelines, the number of creditors is typically never more than a few. The Q&A also makes it clear that the Guidelines may be used by a debtor with only one creditor, Q&A, *supra* note 5, Q.3.

10 It is difficult to obtain accurate data on the number of entities which have used the Corporate Guidelines since they came into existence in September 2001, because they are private and informal. Teikoku Data Bank information suggests that as of 12 October 2006, 35 large companies had used the Corporate Guidelines to obtain financial support: see TEIKOKU DATABANK TDB, *Tokubetsu kikaku: Shiteki seiri ni kansuru gaidorain tekiyō kigyō dōkō chōsa* [Special report: Survey of companies applying under the Workout Guidelines] (16 October 2006), available at <http://www.tdb.co.jp/report/watching/press/p061001.html> last retrieved on 23 June 2012. Another report by the Research Committee for the Corporate Guidelines, led by Shinjiro Takagi, suggests that by 2005, at least 30–40 large and medium-sized entities had used the Guidelines and other entities had used frameworks based on the Corporate Guidelines: see JAPANESE BANKERS ASSOCIATION, *Gaidorain no hyōka oyobi kongo no kadai-tō (kentō kekka hōkoku) oyobi Q&A no ichibu kaitei ni tsuite (shiteki seiri ni kansuru gaidorain kenkyū-kai)* [Issues with the Guidelines' evaluation and future (reporting study results) and revisions of the Q&A (Research Group on the Workout Guidelines)] (4 November 2005), available at <http://www.zenginkyo.or.jp/news/2005/11/04160515.html> (last retrieved on 23 June 2012).

11 The Industrial Revitalisation Corporation was established in May 2003. The Corporation was designed to have a limited lifespan. It used public funds to help revitalize Japanese companies whose insolvency would represent a significant threat to the Japanese economy. See *Sangyō katsuryoku no saisei oyobi sangyō katsudō no kakushin ni kansuru tokubetsu sochi-hō* [Law on Special Measures for Industrial Revitalization], Law No. 131/1999.

12 In 2007, the Law on Special Measures for Industrial Revitalization was amended (see Art. 48) and the Enterprise Revitalisation ADR (Special Alternative Dispute Resolution) Procedure was introduced, which has been used in connection with financially distressed companies such as Japan Airlines: ENTERPRISE TURNAROUND INITIATIVE CORPORATION OF JAPAN, Notice of Decision to Provide Support to Japan Airlines (19 January 2010), available at <http://www.etic-j.co.jp/pdf/100119newsrelease-e.pdf> (last retrieved on 23 June 2012).

13 The Corporate Guidelines were developed with reference to the INSOL8 Principles and were influenced by the success of the so-called London Approach developed by the Bank of England. The Informal Workout Guidelines Research Group was chaired by Shinjiro Takagi and included the Japanese Bankers Association (*Zengin-kyō*), Japan Federation of Econo-

Corporate Guidelines,<sup>14</sup> with amendments to reflect the Guidelines' focus on personal insolvency and dealing with the aftermath of a disaster. The Guidelines are much simpler and do not, for example, require a creditors' committee.<sup>15</sup> Like the Corporate Guidelines, the Guidelines are not legally binding (para. 2 no. 1), but have been drafted by a respected and influential group of industry leaders, bureaucrats and academics, including representatives from financial institutions, who might expect to be affected by debt workouts conducted in accordance with the Guidelines (Introduction; para. 2 no. 1).<sup>16</sup> The Guidelines are relatively friendly to the interests of creditors, reflecting the need to obtain voluntary compliance and co-operation. Unanimous consent to any payment plan proposal is required, for example (para. 9 no. 3).

Debtors' needs may be accommodated in practice by financial institutions and circumstances. In the case of an individual seeking to deal with a residential home loan, for example, it is likely that they will be dealing with only one or at least one main creditor, thus making it possible to obtain unanimous consent. Further, Japanese commentators suggest that financial institutions will be under great social pressure to assist debtors in accordance with the Guidelines.<sup>17</sup>

The Japanese Bankers Association acted as secretariat for the study group established to design the Guidelines, suggesting that the industry as a whole believes that it will benefit by promptly dealing with bad debts.<sup>18</sup> Financial institutions suspended automatic deductions from deposit accounts for home loans from 11 March 2011 for six months where they received a request from a disaster victim. The moratorium was extended again until 11 November 2011.<sup>19</sup> The financial institutions were not in a position to collect debts in any event: many of the disaster victims had no jobs or money; potentially there was no longer any collateral to sell; even if there was collateral, there were no buyers or it was now worth so little that the institution would not recoup the whole amount outstanding; and the whole situation was overwhelming even for the institutions.

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mic Organisations (*Keidan-ren*), members from finance and industry, and academics. See JAPANESE BANKERS ASSOCIATION, *Shiteki seiri ni kansuru gaidorain [Workout Guidelines]*, available at <http://www.zenginkyo.or.jp/news/entryitems/GL010919.pdf> (last retrieved on 6 June 2012); Law on Special Measures for Industrial Revitalization.

14 The Corporate Guidelines reflect the eight INSOL principles for international multi-creditors and were introduced at a time when Japan was still grappling with huge amounts of non-performing loans. For a commentary on the Corporate Guidelines and comparison with the INSOL principles, see S. TAKAGI, *Restructuring in Japan* (Paper prepared for the Global Forum on Insolvency Risk Management, Washington DC 2003), available at <http://siteresources.worldbank.org/GILD/ConferenceMaterial/20158495/Takagi%20-%20Japan%20-%20FINAL.pdf> (last retrieved on 23 June 2012).

15 FUKUOKA, *supra* note 5.

16 For a list of people who participated in the Research Committee which produced the Guidelines, see the list set out at the commencement of the Guidelines, *supra* note 1.

17 FUKUOKA, *supra* note 5.

18 *Ibid.*

19 The authors understand that financial institutions were still basically abiding by this moratorium even as late as December 2011.

Further, there was no incentive for debtors to pay where their house had been washed away, destroyed or damaged. The community were also against financial institutions exercising rights of security in the disastrous circumstances. It would potentially be more advantageous to the Association and its members if the amount owed by debtors was reduced to an amount that they could pay; at least the financial institution would receive some money on the loan and may have the opportunity to make a new loan to advance reconstruction. The rationale for institutions to support informal workouts is similar to institutions who adopt these types of mechanisms outside of Japan. Financial institutions operating in the disaster area are also looking to the future; they hope that new loans will mean that the disaster area will be reconstructed and their own businesses will benefit. There was also a feeling of national camaraderie that everyone should do something to help the victims of such a tremendous disaster. As a Japanese commentator points out, however, there is a limit to how much private firms can forgive and forget in the absence of public funds being used to support the debt forgiveness program.<sup>20</sup>

The successful conclusion of a debt workout under the Guidelines is also supported by provisions requiring creditors to cooperate sincerely (para. 2 no. 2) and confidentiality between the parties (para. 2 no. 3). A creditor is also not supposed to report or register the fact that a debtor is using a debt workout or any information obtained during the workout process with the Japan Credit Information Reference Center Corp. (*Shin'yō jōhō tōroku kikan*) (para. 10 no. 2). Further, the debtor has a duty to perform any finalised payment plan (para. 9 no. 3) established in accordance with the Guidelines, and the creditors must proceed in accordance with its provisions, including in relation to any extension of time or reduction or release of the debtor's obligations (para. 9 no. 3).

## 2. *Comparison of Guidelines with formal insolvency proceedings*

The Guidelines reflect the procedures set out in existing Japanese legislative insolvency proceedings, but enable eligible debtors to avoid public insolvency proceedings. The Minister of Finance suggested that one of the key incentives for debtors to use the Guidelines is to avoid 'voluntary bankruptcy' which would mean that they would 'be blacklisted and lose many rights'.<sup>21</sup> According to Minister Jimi, the Guidelines are designed 'to provide relief in that respect'.<sup>22</sup> The formal procedures available to debtors in Japan include bankruptcy and civil rehabilitation; the individual civil rehabilitation procedure also includes special provisions which deal with secured claims relating to home loans (Civil Rehabilitation Law, Chapter 10, Arts. 196–206).<sup>23</sup> Any formal insolvency proceeding would result in the information provided at the time of the commencement being lodged with credit information agencies. Accordingly, the debtor may have

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20 FUKUOKA, *supra* note 5.

21 JIMI, *supra* note 3.

22 *Ibid.*

23 *Minji saisei-hō*, Law No. 225/1999.

difficulty in accessing credit in future, including to purchase a car or a home, or even obtain a credit card. Further, a call against a guarantor of the insolvent debtor by the creditor may not be able to be resisted in a formal insolvency procedure.<sup>24</sup> If a bankruptcy proceeding is commenced, the bankrupt debtor will also be subject to many restrictions,<sup>25</sup> including restrictions from certain qualifications and moving house or travelling, and the bankruptcy trustee would have control over the debtor's affairs, including managing the debtor's mail (see Bankruptcy Act, Arts. 37, 81 and 82).<sup>26</sup>

The government and other stakeholders created the Guidelines to enable debtors to deal with debts outside of the legislative and, relatively well-resourced, court system, despite having only just finished a decade-long reform effort which culminated in the updating and rewriting of its insolvency legislation and related court procedures. The government did not, however, create the Guidelines because it perceived gaps in formal insolvency law procedures such as the courts being unable to cope. Formal insolvency procedures exist to help with court-driven workouts, but the government and other stakeholders deemed it 'unfair' that disaster victims should have to use those formal procedures when the debtors' main problem was the double impact of having to repay an existing loan as well as a new loan to start over. Further, a functioning formal insolvency regime is necessary for informal procedures to work effectively; if a debt workout under the Guidelines fails, debtors and creditors still have access to the formal mechanisms under insolvency law.

A dramatic increase in business and personal insolvencies in the areas affected by the Great East Japan Earthquake might be expected given the enormity of the disaster, but at the time of writing formal insolvency activity has been subdued. International commentators, however, expect smaller suppliers to continue to suffer and business failures to continue to rise into 2012.<sup>27</sup> Judge Yasufuku Tatsuya of the Sendai District Court (Fourth Civil Division) published a series of legal journal articles in September 2011 reflecting on the impact of the Great East Japan Earthquake on insolvency proceedings in the affected areas.<sup>28</sup> He notes that prior to the disaster, the number of cases for ordinary

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24 See the discussion below on the special treatment of guarantors under the Guidelines.

25 KOBAYASHI, *supra* note 5, 49; FUKUOKA, *supra* note 5.

26 *Hasan-hō*, Law No. 75/2004.

27 HUAXIA D&B CHINA COUNTRY RISK SERVICES, Global Business Failure Report (June 2011), available at [http://www.huaxiadnb.com/UploadFiles/File/2011-7%20DNB\\_Global\\_Failure\\_Report%20EN.PDF](http://www.huaxiadnb.com/UploadFiles/File/2011-7%20DNB_Global_Failure_Report%20EN.PDF) (last retrieved on 23 June 2012), 6.

28 The most relevant articles for this analysis are: T. YASUFUKU, *Tōsan jiken ni okeru shinsai no eikyō to un'yō (6) – Minji saisei jiken ni okeru shinsai no eikyō to shinsai-go no unyō* [The impact of the earthquake and its management on bankruptcy cases (6) – The impact of the earthquake and post-disaster management on civil rehabilitation cases], in: *Kinyū-hō Jijō* [Banking Law Journal] 1930 (2011) 8-10; and T. YASUFUKU, *Tōsan jiken ni okeru shinsai no eikyō to unyō (7) – Hasan jiken ni okeru shinsai-go no dōkō-tō* [The impact of the earthquake and its management on bankruptcy cases (7) – Trends in bankruptcy cases after the earthquake], in: *Kinyū-hō Jijō* [Banking Law Journal] 1931 (2011) 12-17. Tatsuya has also

civil rehabilitation were very few; since 2005, the court dealt with less than 10 cases per year on average.<sup>29</sup> In terms of individual civil rehabilitation cases, Sendai was largely in line with the national average, which meant it dealt with fewer than 300 cases per year. At the time of his writing and publication in September 2011, the court had not dealt with any new ordinary civil rehabilitation cases since the disaster in March 2011. Further, it had only received applications for about 10 individual civil rehabilitations since March 2011 and, in Judge Yasufuku's view, these filings did not suggest that the reason for the applications was the Great East Japan Earthquake in any event.<sup>30</sup>

The reasons for the dramatic decrease in civil rehabilitation cases are not immediately clear even to Judge Yasufuku, but he suggests that victims of the disasters in March 2011 were still focusing on immediate needs such as cleaning up and recovery; they had yet to seriously turn their minds to their real financial circumstances.<sup>31</sup> It is also possible that disaster victims have moved away from the affected area and may seek assistance in other district court jurisdictions.<sup>32</sup> Even if debtors are still in the affected regions, creditors in the regions suffered from the same disasters, and Judge Yasufuku points out that they were not yet in a position to begin making demands.<sup>33</sup> He also notes that it would be difficult for victims who have lost their employment or suffered a decrease in income to utilise the individual civil rehabilitation procedure, because it envisages that a debtor will have access to regular income in the future to meet obligations under any payment plan. Similarly, it would be difficult for individual business operators who might usually file under ordinary civil rehabilitation to use that procedure, because there is little or no possibility of their business continuing or being

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published articles on topics such as guarantee contracts and civil execution after the disasters.

29 *Ibid.*, The impact of the earthquake and post-disaster management on civil rehabilitation cases, 8.

30 *Ibid.*, 8, 9.

31 *Ibid.*, 8.

32 According to one report, of the 510 insolvency filings directly or indirectly relating to the Great East Japan Earthquake, the majority of the filings were made in Tokyo (106), Hokkaido (35), Saitama (32), Fukushima (29), Osaka (25) and Fukuoka (24): TEIKOKU DATABANK TDB, *2011-nen no shinsai kanren tōsan wa 510-ken, Hanshin dai-shinsai-ji no yaku 3-bai* [510 cases of earthquake-related bankruptcy in 2011, three times that of the Great Hanshin Earthquake] (4 January 2012), available at <http://www.tdb.co.jp/report/watching/press/pdf/p120101.pdf> (last retrieved on 23 June 2012). Tokyo and Osaka are traditionally the busiest insolvency jurisdictions in Japan, with companies in particular filing in those jurisdictions even if their head office is outside those metropolitan areas. Tokyo and Osaka judges have the most experience with insolvency cases and arguably are more efficient and up-to-date when it comes to handling those cases. The figures also reflect the nationwide impact of the disasters. Even if individuals and companies in the worst affected areas are not yet in a position to file for insolvency, it appears that people and companies with links to those areas are finding themselves in financial difficulties and filing for formal insolvency proceedings. The geographical distribution of formal insolvency cases may also reflect the focus of relief efforts on the affected areas, rather than nationwide programs.

33 *Ibid.*



rehabilitated, a key plank of the reorganization-type procedures.<sup>34</sup> To the extent that businesses are likely to be able to recover, some of them may have access to public financial assistance, making it unnecessary to file for civil rehabilitation at this time.<sup>35</sup>

The impact of the Great East Japan Earthquake has also been felt in relation to filings for bankruptcy. Between 2006 and 2010, the Sendai District Court Fourth Civil Division received approximately 2000 applications for bankruptcy proceedings per year.<sup>36</sup> In March and April 2011, the Court only received about 50 per cent of the monthly number of bankruptcy filings compared to the same months in 2010.<sup>37</sup> In the period from May to August 2011, the number of filings started to increase, but they were still only about 60 per cent of the monthly figures for 2010, except in June 2011 when the court received just over 80 per cent of the number of filings when compared to June 2010.<sup>38</sup> Although the figures were lower than previous years, the number of filings was trending upwards slightly and the bankruptcy procedure was still being used when compared to the significant drop of filings for civil rehabilitation. The situation accords with Judge Yasufuku's description of Sendai and its surrounds only six months after the disaster: despite some meagre signs of recovery, many people are out of work with no prospects of future employment, and many people worry that recovery is impossible.<sup>39</sup> Judge Yasufuku notes that the vast majority of applications cite the loss of employment or reduction in income as a result of the Great East Japan Earthquake as the key factor in their financial difficulties leading to filing for bankruptcy.<sup>40</sup> In these circumstances, liquidation under a bankruptcy proceeding and a new financial start after bankruptcy was a debtor's preferred option, at least prior to the introduction of the Guidelines.

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34 *Ibid.*

35 *Ibid.*

36 YASUFUKU, Trends in bankruptcy cases after the earthquake, *supra* note 28. These figures include filings by individuals and legal entities. Judge Yasufuku notes that the percentage of filings by legal entities is essentially the same before and after the disasters; that is, approximately 4-5 per cent (*id.*, 13). He expects that this is largely due to the public funds available to legal entities which have been affected by the disasters, but notes that the result is a little surprising given the surge in corporate bankruptcies after the Great *Hanshin Awaji* Earthquake Disaster ('Kobe earthquake'). Judge Yasufuku predicts that the current trend of few corporate bankruptcies may continue in the short term, but that in the long term there may be an increase in filings as public funds dry up and the long-term effects of the disasters become clearer (*id.*, 13). According to information collated by the TEIKOKU DATA BANK, by the end of 2011, the number of insolvency filings directly or indirectly resulting from the Great East Japan Earthquake stood at 510 cases, which is three times that of the filings at the same period after the Kobe earthquake: *supra* note 30. The same report notes that the amount of debt involved is six times that of the Kobe earthquake. The hardest hit industries are construction (91 filings), machine and metal manufacturing (44 filings), hotels (42 filings) and apparel (29 filings).

37 YASUFUKU, Trends in bankruptcy cases after the earthquake, *supra* note 28, 12-3.

38 *Ibid.*

39 *Ibid.*, 12.

40 *Ibid.*, 13. Judge Yasufuku also envisaged that the number of filings would increase as social security benefits ran out, unemployment increased and creditors begin to call in loans.

It was too early for Judge Yasufuku to predict what impact the Guidelines would have on formal insolvency procedure filings at the time of publication of his findings, but he noted that there were a number of built-in obstacles to using the Guidelines that would mean formal insolvency procedures still have a role to play in helping debtors overcome financial difficulties.<sup>41</sup> In particular, he pointed to the eligibility criteria under the Guidelines stipulating that debtors must not have committed an act corresponding to a reason for a forfeiture of benefit of time prior to the Great East Japan Earthquake (para. 3 no. 3); and the requirement that the out-of-court workout must produce a better result than filing for bankruptcy or civil rehabilitation for creditors.<sup>42</sup> Further, a workout under the Guidelines may be terminated where no agreement is reached between the debtor and his/her creditors. The Guidelines do not include cramdown provisions, and all creditors must consent to the proposed plan for it to proceed. He also concluded that formal insolvency proceedings may still be required for debtors who are unable to obtain agreement from their creditors.

### III. OVERVIEW OF THE DEBT WORKOUT PROCESS UNDER THE GUIDELINES

The Guidelines reflect typical Japanese legislative drafting techniques and the variety of opinions held by the diverse group of drafters. Some issues may have been controversial for the drafters to provide final and definitive pronouncements, and others may have been left deliberately ambiguous to allow market participants the chance to adapt the Guidelines to individual cases. The Management Committee, discussed below, has also released a comprehensive fact sheet providing further guidance to debtors and creditors ('Q&A'). The following summary is primarily taken from the translation of the Guidelines by the authors and the Q&A, with references to the relevant paragraph of the Guidelines or question/answer in the Q&A. It is anticipated that a workout under the Guidelines will take from five to six months to complete.<sup>43</sup>

#### 1. *Eligible debtors and relevant creditors*

The Guidelines may only be used by individual debtors who meet certain requirements (para. 3). Legal entities are not eligible to use the Guidelines, but there are other out-of-court mechanisms available to companies facing hardship, including government-funded relief schemes.<sup>44</sup> The requirements reflect the specific focus of the Guidelines on people

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41 *Ibid.*, 14.

42 *Ibid.*

43 FUKUOKA, *supra* note 5.

44 In an effort to bail out companies affected by the Great East Japan Earthquake from the double loan problem, the *Higashi nihon dai-shinsai jigyo-sha saisei shi'en kikō-hō* [Great East Japan Earthquake Business Rehabilitation Support Organisation Law], Law No. 20/2011 was passed on 21 November 2011 and the organisation was formed on 24 February

who have been affected by the disaster formally known as the ‘Great East Japan Earthquake’. The disaster is defined to include the ‘earthquake which occurred on 11 March 2011 in the Tohoku region and Pacific Ocean, together with the disaster resulting from the accident at the nuclear power plant caused by the earthquake and other related disasters’ (see the Introduction to the Guidelines). Accordingly, the Guidelines extend to individuals affected by the nuclear meltdown at Fukushima.

The list of requirements reflects the insolvency tests set out in existing Japanese insolvency laws. First, a debtor affected by the Great East Japan Earthquake is eligible if s/he is ‘unable to pay a residential loan or business-related loan or other [similar] existing debts etc.’ (para. 3 no. 1). The ‘unable to pay’ test corresponds to the concept of *shiharai funō no jōtai* (‘state of insolvency’) already found in the Bankruptcy Act (*Hasan-hō*, Law No. 75/2004, see Art. 2 para. 11; Q&A Q.3-3). Secondly, an affected debtor will also be eligible if ‘it is estimated with certainty that in the near future the debtor will be unable to pay those existing debts’ (para. 3 no. 1). The ‘future’ test corresponds to the concept of *shiharai funō no osore no jōtai* (‘state of risk of insolvency’) already found in the Civil Rehabilitation Act (*Minji saisei-hō*, Law No. 225/1999, see Art. 21; Q&A Q.3-3).

Other requirements reflect the normative stance of the drafters and their definition of deserving debtors. A debtor must be ‘sincere about payment’, ‘properly’ disclose his or her financial situation (para. 3 no. 2) and must not have been in breach prior to the disaster (para. 3 no. 3), unless the creditors otherwise agree. A debtor must also show how ‘it may be expected that it will be economically reasonable’ (para. 3 no. 4) for a creditor to accept the payment plan proposal and participate in the debt workout. One way that a debtor may evidence fulfilment of the ‘economically reasonable’ test is by showing that the workout will provide for a higher return to the creditor than that which would be received from a bankruptcy proceeding or civil rehabilitation proceeding (para. 3 no. 4). Additional examples of ‘economically reasonable’ are listed in the Q&A. These types of eligibility requirements for debtors also reflect the voluntary nature of the Guidelines and the need to obtain creditor agreement to a payment plan proposal. The types of creditors that the drafters anticipate will use the Guidelines include ‘financial institutions etc. (banks, credit unions, credit associations, workers credit unions, agricultural cooperatives, fisheries cooperatives, government-related financial institutions, credit guarantee corporations, agricultural credit fund associations etc. and other guarantee companies, money lending businesses, leasing companies and credit companies etc.)’ (para. 5 no. 5).

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2012. Under the auspices of the organisation, financial institutions have offered debt exemptions and exchanges of non-performing loans for affected businesses. For more information about the organisation, see HIGASHI NIHON DAI-SHINSAI JIGYŌ-SHA SAISEI SHI’EN KIKŌ, *Hajime ni* [Introduction], available at <http://www.shien-kiko.co.jp/introduction.html> (last retrieved on 26 July 2012).

## 2. *Management Committee of Individual Debtor Guidelines for Out-of-Court Workouts*

A Management Committee was established as an *Ippan shadan hōjin* (general incorporated association) to supervise the operation of the Guidelines, (para. 4 no. 1, para. 2; Q&A Q.4-1). The Committee was involved in drafting the Guidelines, and has a significant interest in ensuring their success. Members who were also involved in drafting the Corporate Guidelines in 2001 have learnt from their experiences with corporate informal workouts.<sup>45</sup> The Committee's website states that they do not represent debtors or creditors; rather, they are a not-for-profit entity established on 1 August 2011 under the auspices of the Guidelines to be neutral (*chūritsu*) and fair (*kōsei*), and ensure the effective (*tekikaku*) and smooth (*enkatsu*) operation of the Guidelines.<sup>46</sup> The key representatives are Shinjiro Takagi and Koji Wada. The Committee publicises and conducts drop-in sessions in the most severely affected areas of Iwate, Miyazaki and Fukushima prefectures on a regular basis.<sup>47</sup> It also has a toll-free telephone number for enquiries. It produced a leaflet encouraging victims of the Great Eastern Japan Earthquake to consider using the Guidelines<sup>48</sup> in addition to the Q&A fact sheet for people using the Guidelines.

The Committee also has the power to accept and revoke registrations of lawyers (*bengo-shi*), certified public accountants (*kōnin kaikei-shi*), licensed tax advisers (*zeiri-shi*), licensed real estate valuers (*fu-dōsan kantei-shi*) and other experts assisting debtors to use the Guidelines (para. 4 no. 3 at 1), in addition to its education role. During the workout process, the Committee may assist a debtor in various ways (para. 4 no. 3) and, in

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45 The Research Committee that drafted the Corporate Guidelines released a review and assessment of their operation in 2005. See SHITEKI SEIRI NI KANSURU GAIDORAIN KENKYŪ-KAI [Management Committee of Guidelines for Out-of-Court Workouts], *Gaidorain no hyōka oyobi kongo no kadai-tō ni tsuite – jitsumu WG kentō kekka hōkoku* [Future challenges for the evaluation of the Guidelines: Report on the practical working group's results] (4 November 2005), available at [http://www.zenginkyo.or.jp/news/entryitems/news171104\\_1.pdf](http://www.zenginkyo.or.jp/news/entryitems/news171104_1.pdf) (last retrieved on 5 July 2012). The Committee suggested some amendments to the Corporate Guidelines, including the expansion of their application from large companies to also include small and medium-sized enterprises: JAPANESE BANKERS ASSOCIATION, *Study Group Releases Findings on Guidelines for Multi-Creditor Out-of-Court Workouts*, available at <http://www.zenginkyo.or.jp/en/news/2005/11/04191245.html> (last retrieved on 3 February 2012).

46 KOJIN SAIMU-SHA NO SHITEKI SEIRI NI KANSURU GAIDORAIN KENKYŪ-KAI [Management Committee of Individual Guidelines for Out-of-Court Workouts], *Tō un'ei i'in-kai ni tsuite* [About this committee], available at <http://www.kgl.or.jp/guideline/about.html>, last retrieved on 6 July 2012. See also para. 4 no. 3 of the Guidelines for the specific duties assigned to the Management Committee.

47 *ID.*, *Kobetsu sōdan-kai no shōsai* [Minutes of the individual consultation meetings], available at <http://www.kgl.or.jp/soudan> (last retrieved on 6 July 2012).

48 *ID.*, *Hisai-sha no kata e panfuretto* [Brochures for victims], available at <http://www.kgl.or.jp/victim/leaflets.html> (last retrieved on 6 July 2012).

particular, must provide a report on the workout to the relevant creditors (para. 4 no. 3 at 5, para. 8 no. 1). The report must include the Committee's view about the eligibility of the debtor for a debt workout, the reasonableness of the payment plan proposal and the possibility of the payment plan proposal being successfully executed (para. 8 nos. 2, 3). Accordingly, the Committee plays a significant role in the overall supervision of the workout and is designed to provide an independent, third-party perspective on the payment plan.

Other stakeholders, including lawyers and certified public accountants, may also have an important role to play in assisting debtors to prepare payment plan proposals and gathering the information to be included in the Committee's report (para. 8 no. 1). Their roles are not formally set out in the Guidelines, except to the extent that a payment plan proposal includes a request for the reduction or release of debt; in those cases, a lawyer must have been involved in the preparation of the payment plan proposal and report (para. 8 no. 1, para. 9 no. 1). The use of lawyers in insolvency proceedings is not unusual in Japan: a lawyer would act as trustee in a bankruptcy proceeding, and it appears that this requirement has been followed in the Guidelines in an attempt to increase the perception of reliability of plans which take the serious step of proposing a reduction or release of debt. In practice, the Committee uses a different expert to produce its report, leaving another expert to assist the debtor to prepare the plan itself.

The remuneration of the technical experts registered with the Management Committee is subsidised by the government.<sup>49</sup> According to the Minister for Financial Services, a lawyer would typically charge 290,000 yen for the types of services involved in putting together a payment plan proposal. With the government subsidy, the cost is approximately 100,000 yen.<sup>50</sup> As of 9 September 2011, 625 people had registered with the Committee as technical experts, including *bengo-shi* (439), certified public accountants (19), licensed tax advisers (*zeiri-shi*, 5) and licensed real estate valuers (162).<sup>51</sup>

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49 JIMI, *supra* note 3.

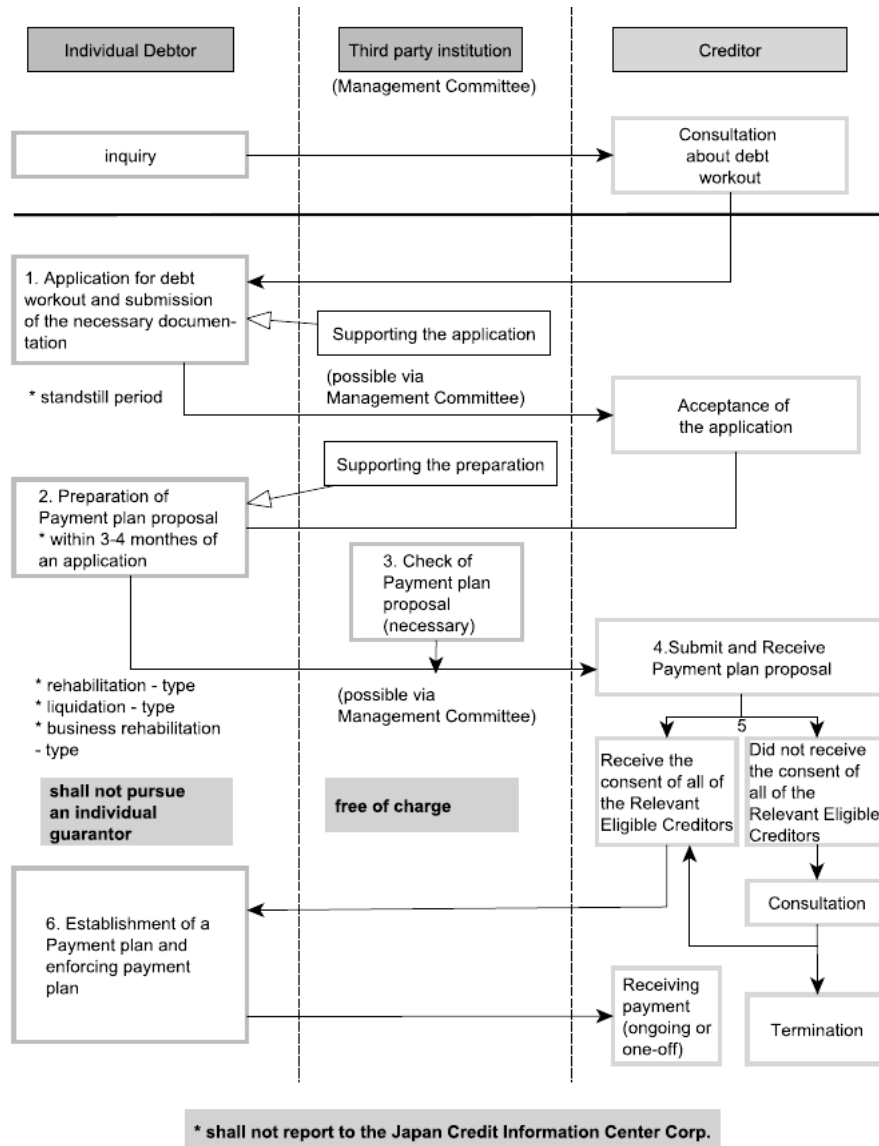
50 *Ibid.*

51 KOJIN SAIMU-SHA NO SHITEKI SEIRI NI KANSURU GAIDORAIN KENKYŪ-KAI [Management Committee of Individual Guidelines for Out-of-Court Workouts], *Tōroku senmon-ka* [Registered professionals], available at <http://www.kgl.or.jp/specialists> (last retrieved on 6 July 2012).

### 3. Process for commencing a debt workout under the Guidelines

Figure 1:

#### Procedural Flow under the Guidelines<sup>52</sup>



\* shall not report to the Japan Credit Information Center Corp.

52 This schematic explanation of the process and roles of the debtor, committee and creditors is based on an original diagram in Japanese. KOJIN SAIMU-SHA NO SHITEKI SEIRI NI KANSURU GAIDORAIN KENKYŪ-KAI [Management Committee of Individual Guidelines for Out-of-Court Workouts], *Tetsuzuki no nagare* [Flow of procedure], available at <http://www.kgl.or.jp/guideline/flow.html> (last retrieved on 7 July 2012).

A debt workout under the Guidelines commences with an application by an eligible debtor in writing either directly to all of his/her relevant eligible creditors or to them via the Management Committee (para. 5). The debtor must provide a list of assets, a list of creditors and any other documentation relevant to the application as soon as possible after submitting the application (para. 5 no. 2). There is no requirement for a debtor to consult with his/her creditors before making an application, but the Management Committee strongly recommends prior consultation (Q&A Q.6).

The Guidelines provide that an application for a debt workout should not constitute a default under the debtor's loan documentation (para. 6 no. 1). Instead, the application triggers a standstill period (para. 5 no. 3), which gives the debtor up to six months to finalise a payment plan (para. 6 no. 2) and determines the outstanding credit exposure for each of the creditors for the purposes of the debt workout (para. 6 no. 1 at 3).<sup>53</sup> During the six-month standstill period, the debtor and creditor are prohibited from taking certain steps. The debtor must not, for example, dispose of assets or take steps to prefer one relevant eligible creditor over another (para. 6 no. 1). The Guidelines allow a debtor to take on additional debt by way of additional financing during the standstill period, provided that all of the relevant eligible creditors consent (para. 6 no. 3). Any funds advanced during the standstill period may be repaid at any time in preference to any obligation owed to a relevant eligible creditor (para. 6 no. 3).

A standstill will be null and void if a creditor objects to an application (para. 5 no. 3). A relevant eligible creditor may object to a debt workout on the following limited grounds: (1) where the debtor does not meet the eligibility requirements set out in para. 3; (2) where the debtor has disposed of assets or taken on new debt without consent of the relevant eligible creditors or performed an act which favours one creditor over another; or (3) where the debtor fails to correct defects within 45 days of the application (para. 5 no. 4).

In line with many Japanese-language documents, where phraseology allows for ambiguity, it is not clear from the Guidelines who may make a decision about whether the objection circumstances are 'clear'. The ability of a creditor to unilaterally terminate a debt workout, albeit for limited reasons, also reflects the creditor-bias of the Guidelines; this seems to have been necessary to obtain voluntary compliance from financial institutions. A debt workout may also be terminated at the end of the standstill period if there is no agreement about a payment plan proposal within the standstill period (para. 6 no. 2).

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53 The parties may agree to an extension of the standstill period (Guidelines para. 6 no. 2).

#### 4. *Process for preparing and submitting a payment plan proposal*

Payment plan proposals may be divided into three types under the Guidelines: (1) plans which provide for future repayments where an individual has future earning capacity ('rehabilitation-type'); (2) plans which provide for the liquidation of assets, a lump sum payment and discharge of all remaining debts ('liquidation-type'); and (3) plans involving individual business operators who wish to continue business ('business rehabilitation-type') (para. 7 no. 2 generally). The content requirements vary slightly depending on which type of plan is proposed. The rehabilitation-type plan contents track the requirements for plans under existing Japanese insolvency proceedings.<sup>54</sup> To the extent that a debtor wants creditors to agree to a rehabilitation-type plan, the payment amount is to reflect the debtor's income and assets, but it is expected to create a return to creditors that is greater than they would receive in a bankruptcy proceeding (para. 7 no. 2 at 1 (b)). The report prepared by the Committee must also set out details of a comparison between the plan's proposed distribution and what may be available in a bankruptcy proceeding to the extent that the plan calls for a reduction or release of debt (para. 8 no. 2 at 5). American experience suggests that the most difficult aspect of a rehabilitation-type plan when dealing with financial hardship is making sure that the new repayment amounts and terms are not set too high; thus setting debtors up to fail.<sup>55</sup>

The possibility of liquidation-type plans is unique to the new Guidelines. The Corporate Guidelines did not provide for the possibility of a plan that focused on liquidation, and they are typically not a feature of financial hardship schemes in other jurisdictions, such as the United States of America or Australia. For a liquidation-type plan, general priority rules apply in respect of paying distributions (including giving preference to secured creditors and priority creditors), but a debtor may retain certain assets ('free assets') which would also ordinarily be excluded from a bankruptcy estate (para. 7 no. 2 at 1 (c); Bankruptcy Act Art. 34 paras. 3, 4). So-called free assets include a monetary amount of less than 5,000,000 yen<sup>56</sup> and household items. Similarly to formal bankruptcy proceedings involving disaster victims, defining the scope of free assets is likely to be the most controversial and difficult aspect of liquidation-type plans.<sup>57</sup> Any amounts received as part of disaster relief payments are also exempt assets and not available for distribution to creditors.<sup>58</sup> Further, creditors who are owed less than 200,000 yen are excluded from

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54 The contents of the plan are specified in the Guidelines (para. 7 no. 2).

55 G. MORGENSON, *Why the U.S. Needs Plan B for Mortgages*, in: *International Herald Tribune (Business)*, 7 December 2009, 24.

56 See also the discussion below in relation to the use and future of the Guidelines.

57 See YASUFUKU, *supra* note 28.

58 These payments are protected by legislation: see *Saigai chōi-kin no shikyū-tō ni kansuru hōritsu oyobi hisai-sha seikatsu saiken shi'en-hō no ichibu o kaisei suru hōritsu* [Act Amending the Natural Disaster Victims Relief Act and the Act on Provision of Disaster Condolence Grants], Law No. 100/2011; *Higashi nihon dai-shinsai kanren gi'en-kin ni kakaru sashiosae kinshi-tō ni kansuru hōritsu* [Act for the Prohibition of Seizure of Donations



the definition of relevant eligible creditors for the purposes of a liquidation-type plan (para. 7 no. 2 at 1 (c)). It is very likely that the focus of many of the plans finalised under the Guidelines will be liquidation. As Judge Yasufuku of the Sendai District Court points out in the context of the significant decrease in civil rehabilitation filings in the affected region, many of the victims of the disasters are very unlikely to be able to continue their businesses and may have lost their employment.<sup>59</sup> Rehabilitation-type plans and procedures generally assume some capacity to rebuild a business or earn an income.

The individual debtor must submit a payment plan proposal within three months of an application for a debt workout, although an extension of a further three months may be obtained without consent from the relevant eligible creditors (para. 7 no. 1). The initial time period is four months for individual business operators submitting a business rehabilitation-type plan to rebuild or continue his/her business by making payments from revenue generated by that business (para. 7 no. 1). The additional month is designed to give these debtors time to collate the additional information required for his/her payment plan proposal, including business forecasts setting out expected sales, costs and expenses, and a business plan and an explanation for any net losses which occurred prior to the Great East Japan Earthquake (para. 7 no. 2 at 2 (a)).

Before approving any plan, creditors are entitled to ask for a meeting with the debtor and have them explain the payment plan proposal and report (para. 9 no. 1). Questions and answers may be exchanged between the creditors and debtor in writing if the creditors consent in writing (para. 9 no. 1), which is most likely to occur in cases where there are only a few creditors to consent and the process can be managed efficiently. Creditors are required to inform a debtor of their decision within one month of the meeting to explain the payment plan proposal and report (para. 9 no. 2). A payment plan proposal will take effect when all of the creditors consent to it in writing (para. 9 no. 3). If it is not possible to obtain the consent of all creditors, even allowing for more time and amendments to the payment plan proposal, the debt workout under the Guidelines will be terminated (para. 9 no. 4).

Finally, if it becomes apparent that a debtor is unable to perform an agreed payment plan, s/he and the creditors are required under the Guidelines to consider amendments to the payment plan and 'take appropriate measures' (para. 10 no. 1). Accordingly, confirmation of a payment plan does not necessarily conclude dialogue between the debtor and his/her creditors. It is easy to imagine that a debtor suffering financial hardship in the context of a natural disaster may need additional assistance to adjust to his/her changing circumstances. The Guidelines do not offer any further advice on dealing with debtors who seek further debt workouts; they do not, for example, prohibit a debtor from using the Guidelines for a debt workout multiple times.

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Relating to the Tohoku Earthquake], Law No. 103/2011, which became effective on 30 August 2011.

59 YASUFUKU, *supra* note 28.

### 5. *Treatment of guarantors*

An important aspect of the Guidelines is the ability for payment plan proposals to take into account guaranteed debts owed by guarantors, a common feature of personal finance in Japan. The treatment of guarantors distinguishes the Guidelines generally from formal insolvency proceedings in Japan and may be a reason to use the Guidelines instead of formal insolvency proceedings which do not prohibit a creditor from pursuing a guarantor.<sup>60</sup> A creditor's ability to make a demand against a guarantor whose capacity to pay has been affected by the Great East Japan Earthquake is limited to only 'reasonable' circumstances under the Guidelines (para. 7 no. 5; Q&A Q.7-14).<sup>61</sup> The Guidelines do not make it clear who has the power to determine what is 'reasonable', but they do offer guidance as to what factors must be taken into consideration, including the circumstances of the execution of the guarantee contract; the relationship between the principal debtor and the guarantor; the extent to which the guarantor obtained a profit or benefit from the underlying guarantee (Q&A Q.7-13); and the guarantor's personal circumstances, such as the impact of the Great East Japan Earthquake, income and assets (para. 7 no. 5). To the extent that a guarantor agrees to make a payment under a guarantee, s/he may be joined as a party to the payment plan and any repayments may be provided for under that plan (para. 7 no. 5, at final paragraph).

## IV. CURRENT OPERATION OF THE GUIDELINES

### 1. *Lack of use of the Guidelines*

The government has supported efforts to publicise the new Guidelines,<sup>62</sup> but the scheme has not been used by as many people as the government first predicted. Despite an initial rush of consultations on the first day, the number of enquiries and registrations under the scheme is low compared to the estimated 10,000 to 20,000 who might be eligible.<sup>63</sup> During the period since the Guidelines came into effect on 22 August 2011 until the end of October 2011, the Guidelines' hotline received over 1200 calls, but only a few have resulted in the Guidelines being applied. The Committee's own statistics reveal that only 150 people were introduced to a registered technical expert during the first two months of the scheme's operation (see *Table 1*).<sup>64</sup>

60 FUKUOKA, *supra* note 5.

61 In Australia, a prohibition on making a demand under a guarantee is an important feature of the Voluntary Administration procedure set out in the Corporations Act 2001 (Cth).

62 JIMI, *supra* note 3.

63 *Ibid.* The Minister's estimate is based on consultations with financial institutions in the three most affected prefectures (Iwate, Miyagi and Fukushima). The government found that there were an estimated 18,000 debtors who had suspended repayments on existing loans.

64 ISSHA HŌJIN KOJIN-BAN SHITEKI SEIRI GAIDORAIN UN'EI I'IN-KAI [General Incorporated Association Individual Workout Guidelines Management Committee], *Kojin-ban shiteki seiri gaidorain, otoi'awase kensū-tō, heisei 23-nen 8-gatsu 22-nichi kara heisei 23-nen 10-gatsu*

Table 1

*Cases dealt with under the Guidelines*<sup>65</sup>

	<i>Number of inquiries (cumulative)</i>			
	22 August 2011 to 21 October 2011	22 August 2011 to 27 January 2012	22 August 2011 to 15 June 2012	22 August 2011 to 20 July 2012
<i>Total inquiries</i>	1,232	2158	3181	3313
<i>General inquiries</i>	469	743	1075	1142
<i>Individual consultations</i>	763	1415	2106	2272
<i>Total number of debtors introduced to a registered expert</i>	150	286	353	351

<i>Cases which have filed for a debt workout (involving the Management Committee) (cumulative)</i>				
<i>Total cases</i>	32	103	284	300
<i>Tokyo Branch</i>	3	7	9	11
<i>Aomori Branch</i>	-	-	-	-
<i>Iwata Branch</i>	10	27	77	81
<i>Miyagi Branch</i>	17	61	182	193
<i>Fukushima Branch</i>	2	7	15	15
<i>Ibaraki Branch</i>	-	1	1	

21-nichi made [Guidelines for Workouts: Number of Inquiries from 22 August 2011 to 21 October 2011], available at <http://www.kgl.or.jp/kensuu> (last retrieved on 25 October 2011).

65 This table has been created by the authors based on data from ISSHA HÖJIN KOJIN-BAN SHITEKI SEIRI GAIDORAIN UN'EI I'IN-KAI [General Incorporated Associations Individual Workout Guidelines Management Committee], *Kojin-ban shiteki seiri gaidorain, otoi'awase kensū-tō* [Guidelines for Workouts: Number of Inquiries], updated periodically at <http://www.kgl.or.jp/kensuu/>: *Heisei 23-nen 8-gatsu 22-nichi kara heisei 23-nen 10-gatsu 21-nichi made* [22 August 2011 to 21 October 2011] (last retrieved on 25 October 2011); *Heisei 23-nen 8-gatsu 22-nichi kara heisei 24-nen 1-gatsu 27-nichi made* [22 August 2011 to 27 January 2012] (last retrieved on 27 January 2012); *Heisei 23-nen 8-gatsu 22-nichi kara heisei 24-nen 6-gatsu 15-nichi made* [22 August 2011 to 15 June 2012] (last retrieved on 15 June 2012); *Heisei 23-nen 8-gatsu 22-nichi kara heisei 24-nen 7-gatsu 20-nichi made* [22 August 2011 to 20 July 2012] (last retrieved on 25 July 2012).

As the statistics set out above show, by July 2012 the Management Committee had facilitated 2272 consultations and introduced 351 cases to technical experts such as lawyers.<sup>66</sup> Further, 300 cases were filed: 193 in Miyagi Prefecture, 81 in Iwate Prefecture, 15 in Fukushima Prefecture, and 15 in Iwate Prefecture and Tokyo.<sup>67</sup>

## 2. *Lack of understanding about the Guidelines – Information sessions*

There are a number of reasons for the Guidelines' lack of use, particularly when compared with the government's initial estimates. The reasons include a lack of information and understanding about the Guidelines and services offered by the help desks; obstacles to claims being made by debtors as a result of the requirements in the Guidelines; and problems inherent in informal insolvency mechanisms. At the time of their introduction, there were complaints that the Guidelines were difficult to understand. At a press conference the day after the Guidelines came into effect, the Minister for Financial Services responded that

[i]n response to such complaints, I have instructed that PR about the Guidelines of Workout for Restructuring Debt Owed by Individual Debtors be made through as easy-to-understand TV ads as possible - maybe we should seek your advice in this respect [comment to reporter].

As you know well, if we leave it to bureaucrats to do PR, they tend to try to provide all-inclusive explanations as they worry about the risk of problems arising from failure to mention everything possible. PR professionals highlight only the key points. When we see ads, we pay attention only to the key points. It has traditionally been a problem that government PR attracts little attention. To put it simply, the essence of administration is different from the essence of PR in that from the perspective of administration, a selective approach used in PR may entail problems. I will take responsibility in that respect. The important thing to do is to raise awareness with clear explanations and encourage people to seek consultation. As many people are facing hardship, we are considering how to reach out to their hearts through user-friendly PR. We will appreciate advice from you media people.<sup>68</sup>

Since then, the General Incorporated Association Individual Workout Guidelines Management Committee has set up an extensive website for individuals suffering financial hardship and their advisers. It includes step by step instructions for individuals, various

66 ISSHA HŌJIN KOJIN-BAN SHITEKI SEIRI GAIDORAIN UN'EI I'IN-KAI [General Incorporated Association Individual Workout Guidelines Management Committee], *Kojin-ban shiteki seiri gaidorain, otoi'awase kensū-tō* [Guidelines for Individual Workouts: Number of Inquiries], *Heisei 23-nen 8-gatsu 22-nichi kara heisei 24-nen 7-gatsu 20-nichi made* [22 August 2011 to 20 July 2012], available at <http://www.kgl.or.jp/kensuu> (last retrieved on 25 July 2012).

67 *Ibid.*

68 JIMI, *supra* note 3. The Japanese government orchestrated very effective publicity campaigns at the commencement of the Civil Rehabilitation Act in 2000 and leading up to the Lay Judges Act (*Saiban-in no sanko suru keiji saiban ni kansuru hōritsu*), Law No. 63/2004, which came into force in May 2009.

documents such as simple forms for registering assets and liabilities, and a draft payment plan setting out spaces for dates, amounts and creditors.<sup>69</sup>

3. *Obstacles to greater use arising from the nature of the Guidelines themselves – adjustments to the application of the Guidelines in practice*

Adjustments to the operation of the Guidelines have also been made to increase their use. In addition to the increase in ‘free assets’ discussed below, the Management Committee has suggested an expansion of debtor eligibility. The definition of eligibility in the Guidelines excludes many people in practice. A person who is eligible for the Guidelines is defined as a person who is unable to pay or who is estimated with certainty to be unable to pay in the near future.<sup>70</sup> In application, this means that the Guidelines are generally only available to people whose expenses exceed their current income.

However, many of the disaster victims are living in temporary housing or with relatives and are not paying rent. Because their housing costs are zero, any income they earn is likely to exceed their expenditure, largely excluding them from the Guidelines’ eligibility criteria. Similarly, debtors who have been heavily impacted by the disasters but whose income has not decreased as a result or who possess other assets such as land are also ineligible under the Guidelines. There are also reports of people who are unemployed at the time they apply for a debt workout but are nevertheless considered ineligible because of the likelihood of them obtaining some employment in the future.<sup>71</sup> The Guidelines also do not make it clear how to treat people who are able to meet their current debts, but whose income is insufficient to enable them to take out a new loan to rebuild.<sup>72</sup>

Given the *raison d’être* of the Guidelines is to help deal with the double loan crisis and allow debtors to rebuild houses and businesses, denying assistance in these situations appears to run counter to the spirit of the Guidelines. While there are no immediate plans to amend the Guidelines’ eligibility requirements in the text of the Guidelines, the Management Committee made its first revision to the operation of the Guidelines on 26 October 2011. The revision states that even if the debtor does not have any accommodation costs, they shall be treated as having accommodation costs in the near future when the assessment is made as to their eligibility for the application of the Guidelines.<sup>73</sup>

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69 KOJIN SAIMU-SHA NO SHITEKI SEIRI NI KANSURU GAIDORAIN KENKYŪ-KAI [General Incorporated Association Individual Workout Guidelines Management Committee], *Gaidorain ni tsuite: Shoshiki ichiran* [About the Guidelines: List Format], available at <http://www.kgl.or.jp/guideline/format.html> (last retrieved on 6 July 2012).

70 Guidelines Art. 3 para. 1.

71 ASAHI SHINBUN, *supra* note 5.

72 FUKUOKA, *supra* note 5.

73 *Kojin saimu-sha no shiteki seiri ni kansuru gaidorain’ no un’yō no minaoshi ni tsuite (Kasetsu jūtaku kariage jūtaku ni nyūkyo-chū no katagata ni tsuite un’yō minaoshi)* [Review

#### 4. *Some inherent problems with informal workout mechanisms*

The extent to which informal workout mechanisms such as the Guidelines are different and easier to use when compared to formal mechanisms is one of the key factors in whether they will be utilised by debtors. The Japanese government and Management Committee have made it clear that helping debtors to work out double loan obligations without entering into formal insolvency proceedings such as bankruptcy was an important driver for the introduction of the Guidelines. The Guidelines, however, closely reflect existing Japanese formal insolvency mechanisms, in particular, the eligibility requirements for a debtor and the content of a plan. To qualify for the Guidelines, a debtor has to establish that s/he is at the brink of a bankruptcy or civil rehabilitation filing, which involves relatively high hurdles. Further, the assets available for a debtor to keep in the case of a liquidation-type plan originally only included 990,000 yen, which is the same amount usually available under the Bankruptcy Act (Art. 204 para. 1). On 23 January 2012, the Management Committee made its second change to the operation of the Guidelines; although, once again, the text of the Guidelines themselves has not been amended. The second amendment involved the increase of the scope of the so-called bankruptcy ‘free assets’ from 990,000 yen to 5,000,000 yen.<sup>74</sup> Accordingly, it may be that the impact of this amendment is that more people will use the Guidelines, because they will be able to keep this amount for their own personal use – that is, it is not available for distribution to creditors. Furthermore, any amounts received as part of disaster relief payments will also be exempt assets and not available for distribution to creditors.<sup>75</sup>

The move by the Management Committee to increase the amount of free assets available also reflects practical developments in bankruptcy courts such as the Sendai District Court Fourth Civil Division. Writing in August 2011, at the time the Guidelines became effective, Judge Yasufuku highlighted the need for courts in affected regions to consider increasing the scope of the ‘free assets’ available to bankrupts affected by the disasters, particularly those who had received insurance and other payments.<sup>76</sup> He noted that the burden of trying to balance the competing interests of bankrupts who are disaster victims and require any payments from insurers or relief agencies to rebuild their lives

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of the Operation of the Guidelines for Individual Debtor Out-of-Court Workouts: Revision of its Operation for People Who Move into Rented or Temporary Housing] (23 October 2011), available at <http://www.kgl.or.jp/news/20111025.html> (last retrieved on 6 July 2012).

74 *Kojin saimu-sha no shiteki seiri ni kansuru gaidorain' no un'yō no minaoshi ni tsuite (Jiyū zaisan no kakuchō)* [Review of the Operation of the Guidelines for Individual Debtor Out-of-Court Workouts: Extension of Free Assets] (25 January 2012), available at <http://www.kgl.or.jp/news/20120125.html> (last retrieved on 6 July 2012).

75 *Supra* note 58.

76 T. YASUFUKU, *Tōsan jiken ni okeru shinsai no eikyō to un'yō (5) — Kanzai gyōmu e no eikyō to sono taisho-tō (2)* [The Impact of the Earthquake and its Management on Bankruptcy Cases (5) – The Impact on Frozen Businesses and Measures for Dealing with the Situation (2)], in: *Kinyūhō Jijō* [Banking Law Journal] 1928 (2011) 6-9.

and creditors who shouldn't be unduly prejudiced by any expansion of the free assets in accordance with the Bankruptcy Act will largely fall to bankruptcy trustees.<sup>77</sup> Under the Bankruptcy Act, the scope of the free assets may be expanded by the court based on the recommendation of the bankruptcy trustee (Art. 34(5)), and there are examples of previous cases where the scope has been extended.<sup>78</sup> From a macro perspective, the court is also concerned about establishing equity and fairness with other bankrupts who haven't been affected by the disasters.<sup>79</sup> Judge Yasufuku also argues persuasively that the general amount of free assets of 990,000 yen should be increased for disaster victims because that amount was based on a calculation of the amount of money it would cost for the necessities of life over a period of three months in ordinary circumstances.<sup>80</sup> Given the extraordinary circumstances faced by disaster victims, it would seem reasonable that an allowance should be made for the time that it will take victims to be able to return to some semblance of a normal life, which is conceivably much longer than three months.

Formal Japanese insolvency procedures are being adapted to deal with the crisis in other ways as well. The Great East Japan Earthquake has affected the cases that were already before the court, for example, because the relevant civil rehabilitation plans of the applicants have little chance of being successful given that they lost their jobs, suffered a decrease in income or lost assets as a result of the disasters.<sup>81</sup> Accordingly, it has been necessary to extend the time allowed for a number of plans to be filed or amended under the civil rehabilitation procedure.<sup>82</sup> The court is also grappling with issues such as how to treat insurance proceeds and relief money received by debtors under the civil rehabilitation procedure.<sup>83</sup> Although such monies may be treated as 'free assets' under the Bankruptcy Act, which may be retained by a bankrupt, there is no similar mechanism under the civil rehabilitation procedure. The court is continuing its consultations with the local lawyers association, but it plans to run test cases based on the 'free asset' provisions of the Bankruptcy Act where these various funds are available to debtors who file or have filed for civil rehabilitation.<sup>84</sup> The court also plans to appoint an individual rehabilitation officer to each case involving these complex issues, even where the debtor already has legal representation; previously, the court generally did not appoint an officer if the debtor was represented by a lawyer.<sup>85</sup>

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77 *Ibid.*, 7.

78 *Ibid.*

79 *Ibid.*

80 *Ibid.*, 8.

81 YASUFUKU, *supra* note 28, 8.

82 *Ibid.*, 9.

83 *Ibid.*

84 *Ibid.*, 10.

85 *Ibid.*

The flexible approach to resolving practical issues arising out of specific insolvency circumstances taken by the courts is not new in Japanese insolvency proceedings. There are examples of different practices arising between jurisdictions to suit local customs and circumstances even before the insolvency reforms of the late 1990s, in particular the difference between the three major insolvency jurisdictions: the District Courts in Tokyo, Osaka and Nagoya. As the examples from the Sendai District Court show, the courts are actively applying legislative provisions to accommodate the needs of disaster victims. Accordingly, the Guidelines should not be seen as a failure of the Japanese judicial system to adequately deal with the double loan crisis. One of the key criticisms of the pre-Heisei reforms to the Japanese insolvency law regime was a lack of transparency; too many financial problems were dealt with in the shadow of the law, which enabled shady lenders and loan sharks to influence the industry. The Guidelines, however, do not reflect a move back to informal procedures at the expense of a functioning formal insolvency regime. The Guidelines have a limited application and rely on an effective formal insolvency system to deal with cases where unanimous consent cannot be obtained from creditors.<sup>86</sup>

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86 One of the recommendations of the Committee reviewing the Corporate Guidelines in 2005 was that 'legislation and other measures need to be established to ensure smooth coordination among parties and promote quick business revitalization', because, according to the Japanese Bankers Association, the Corporate Guidelines require, in principle, the unanimous consent of all relevant creditor financial institutions to a revitalization proposal and this was 'actually impractical': see SHITEKI SEIRI NI KANSURU GAIDORAIN KENKYŪ-KAI, *supra* note 45.



## V. CONCLUSION: MARKET REACTION AND FUTURE PROSPECTS FOR THE GUIDELINES

Despite the limited application and initial low take-up of the Guidelines, they provide additional flexibility to Japan's modern insolvency procedures and reflect global trends for dealing with debtors in financial hardship.<sup>87</sup> The Guidelines could also form a precedent for dealing with insolvencies arising out of future disasters in Japan. There are good reasons for the operation of the Guidelines to be extended beyond their initial purpose of combating the double loan crisis after the Great East Japan Earthquake. From a debtor's perspective, s/he may avoid potential social and credit-history stigma associated with formal insolvency proceedings, as well as restrictions arising from, in particular, a bankruptcy proceeding by using the Guidelines. S/he may also obtain the services of expert assistance at a very reasonable rate. Further, the Guidelines provide a mechanism for dealing with guaranteed debt by reducing it to the level of any agreed debt reduction or release (para. 7 no. 5; Q&A Q.7-13, Q.7-14). From a creditor's perspective, the National Tax Agency of Japan has confirmed that a financial institution that accepts a payment plan which includes a forgiveness of debt will not, in principle, be subject to tax in respect of that amount.<sup>88</sup> The Japanese government's support, however, did not go so far as schemes supporting subprime borrowers in the United States of America where the government meets at least part of the loss suffered by a financial institution as a result of changes to mortgage provisions to help eligible debtors meet their loan repayments.<sup>89</sup>

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87 See, for example, US DEPARTMENTS OF THE TREASURY AND HOUSING AND URBAN DEVELOPMENT, Home Affordable Modification Program (HAMP) (27 January 2012), available at <http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx> (last retrieved on 2 February 2012). The drivers for these schemes vary depending on the jurisdiction. A greater emphasis was placed on these schemes in the United States, for example, after the global financial crisis. Recent natural disasters requiring unprecedented support for housing include floods in Queensland, Australia and earthquakes in Christchurch, New Zealand. For an overview of the Australian situation, see AUSTRALIAN BANKERS' ASSOCIATION, *Doing it Tough? Government's Hardship Principles*, available at <http://www.doingittough.info/content/government%E2%80%99s-hardship-principles> last retrieved on 6 July 2012. For a copy of the Hardship Principles, see W. SWAN, Deputy Prime Minister and Treasurer, *Relieving Mortgage Stress – The Principles: A Common Approach for Assisting Borrowers Facing Financial Hardship* (Media Release, 5 April 2009), available at <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/034.htm&pageID=003&min=wms&Year=2009&doctype=0>, last retrieved on 6 July 2012.

88 NATIONAL TAX AGENCY, *Kojin saimu-sha no shiteki seiri ni kansuru gaidorain ni motozuki sakusei sareta bensai keikaku ni shitagai saiken hōki ga okonawareta ba'ai no kazei kankei ni tsuite* [Tax in Circumstances where Debt Relief Payment Plans are Prepared in Accordance with the Guidelines for Individual Debtor Out-of-Court Workouts], available at <http://www.nta.go.jp/shiraberu/zeiho-kaishaku/bunshokaito/hojin/110816/index.htm> (last retrieved on 6 July 2012).

89 Fukuoka argues that without an economic incentive such as the one provided by the government of the United States of America, it is difficult to see how private firms can bear the burden of all of the debt, estimated at 727 billion yen as of October 2011 (roughly 7 billion euros at that time [*the eds.*]): TEIKOKU DATABANK TDB, *supra* note 32. Fukuoka

Creditors have little to lose in utilising the Guidelines given that they are under no legal obligation to consent to any debt reduction or release. Although there is also anecdotal evidence that financial institutions are individually negotiating workouts directly with debtors and obtaining terms more favourable to the institutions than what they might otherwise achieve under the Guidelines, the Management Committee is now trying to convince the banks to change this situation.<sup>90</sup> Financial institutions may find themselves under social and political pressure to agree to more payment plan proposals in future if too many applications are refused or institutions seek to bypass the guidelines.

#### ABSTRACT

*This article presents the first detailed English-language analysis of the Guidelines for Individual Debtor Out-of-Court Workouts ('Guidelines') and complements a tentative translation of the original Japanese version translated into English by the authors. The immediate catalyst for the publication of the Guidelines in August 2011 was the so-called 'double loan crisis', which refers to the situation where some victims of the Great East Japan Earthquake are suffering from the double hardship of paying out existing loans whilst seeking new finance to rebuild lives, businesses and homes; the Guidelines are designed to help individuals (kojin) overcome such financial hardship. The Guidelines were pulled together very quickly and commenced operation on 22 August 2011, but they build on other established out-of-court procedures in Japan dealing with corporate insolvency, including the Guidelines for Multi-Creditor Out-of-Court Workouts ('Corporate Guidelines'), the operation of Japan's Industrial Revitalization Commission and the Enterprise Revitalisation ADR Procedure. The procedure and wording of the Guidelines are closely based on the Corporate Guidelines with amendments to*

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was writing in September 2011, just one month after the Guidelines came into effect, and he reserved his final judgement until more could be known about the operation of the Guidelines: FUKUOKA, *supra* note 5. Differences between financial hardship schemes reflect their origins: the Government in the United States of America was dealing with financial institutions suffering financial difficulties as well as their borrowers; it appears that the financial institutions in the affected areas are basically sound and do not require the same sort of government support.

90 NICHIBEN-REN [Japan Federation of Bar Associations], *Hisai rōn genmen seido (kojin-ban shiteki seiri gaidorain) no saranaru sekkyoku katsuyō o motomeru kaichō seimei – un'yō kaishi kara 1-shūnen o mukaeru ni atatte* [One Year After the Guidelines for Individual Out-of-Court Workouts First Began Operating, the Minister Encourages Further Use of the Guidelines to Help Manage the Double Loan Crisis], available at [http://www.nichibenren.or.jp/activity/document/statement/year/2012/120803\\_2.html](http://www.nichibenren.or.jp/activity/document/statement/year/2012/120803_2.html) (last retrieved on 17 September 2012).

reflect the Guidelines' focus on personal insolvency and dealing with the aftermath of a disaster. The article gives a detailed commentary of the Guidelines' provisions and compares them to existing formal Japanese insolvency procedures. The Guidelines reflect typical Japanese legislative drafting techniques and the variety of opinions held by the diverse group of drafters. Some issues may have been controversial for the drafters to provide final and definitive pronouncements, and others may have been left deliberately ambiguous to allow market participants the chance to adapt the Guidelines to individual cases.

The article also examines the drivers and stakeholders which led to the Guidelines' creation, and argues that their limited success is not just due to a failure in public relations. The government estimated that up to 20,000 people might be eligible for the Guidelines, but very few people have benefited from the Guidelines. Only 300 individual plans were filed in the first 12 months of the Guidelines operation, despite over 2000 consultations being facilitated. The article examines the current status and operation of the Guidelines and argues that these types of informal mechanisms have an important role to play in a functioning insolvency regime, despite some initial teething problems. They also provide additional flexibility to Japan's modern insolvency procedures and reflect global trends for dealing with debtors in financial hardship. Japanese courts are also building on a tradition of flexibly resolving practical issues arising out of specific insolvency circumstances, which should lead to better outcomes for disaster victims. Creditors have little to lose in utilising the Guidelines given that they are under no legal obligation to consent to any debt reduction or release, but there is anecdotal evidence that financial institutions are individually negotiating workouts directly with debtors and obtaining terms more favourable to the institutions than what they might otherwise achieve under the Guidelines. Financial institutions may find themselves under social and political pressure to highlight the existence of the Guidelines to disaster victims and agree to more payment plan proposals in future.

#### ZUSAMMENFASSUNG

Der Beitrag ist die erste detaillierte Untersuchung der „Richtlinien für die außergerichtliche Novation bei Einzelschuldnern“ (fortan: Richtlinien) und ergänzt eine vorläufige Übersetzung der japanischen Originalversion ins Englische durch die Autoren. Unmittelbarer Auslöser für die Veröffentlichung der Richtlinien im August 2011 war die sog. „Doppelkreditkrise“, womit die Lage bezeichnet wird, in der sich einige Opfer des großen Erdbebens in Ostjapan befinden, die der doppelten Belastung ausgesetzt sind, bestehende Kredite zurückzahlen zu müssen und sich gleichzeitig um Mittel für ihren Lebensunterhalt und zum Wiederaufbau ihrer Unternehmen und Eigenheime bemühen müssen. Die Richtlinien sind darauf angelegt, natürlichen Personen (kojin) die Überwindung solch harter finanzieller Umstände zu erleichtern. Sie wurden rasch geschnürt

und gelten seit dem 22. August 2011, aber bauen auf anderen, in Japan bestehenden außergerichtlichen Verfahren auf, die sich mit der Insolvenz von Unternehmen befassen, einschließlich der „Richtlinien für die außergerichtliche Novation bei Gläubigermehrheit“ (fortan: Unternehmensrichtlinien), des Verfahrens von Japans „Industrial Revitalization Commission“ und der „Enterprise Revitalization ADR Procedure“. Das Verfahren und der Wortlaut der Richtlinien basieren weitgehend auf den Unternehmensrichtlinien und enthalten Änderungen, um den Schwerpunkt der Richtlinien auf die Privatinsolvenz sowie ihren Bezug zu den Auswirkungen der Katastrophe widerzuspiegeln. Der Beitrag kommentiert die einzelnen Vorschriften der Richtlinien ausführlich und vergleicht sie mit den bereits bestehenden, förmlichen Insolvenzverfahren in Japan. Die Richtlinien spiegeln typisch japanische Techniken der Gesetzesabfassung und die Meinungsvielfalt unter den Verfassern wider. Einige Probleme waren wohl zu umstritten, um endgültige und definitive Antworten zu geben, andere scheinen absichtlich unklar belassen worden zu sein, um es den Marktteilnehmer zu überlassen, die Richtlinien an individuelle Fälle anzupassen.

Der Beitrag untersucht auch die politische Dynamik und die Akteure, die auf die Schaffung der Richtlinien hingewirkt haben, und vertritt die Auffassung, dass deren eingeschränkter Erfolg nicht nur auf eine mangelhafte Öffentlichkeitsarbeit zurückzuführen ist. Zwar schätzt die Regierung, dass bis zu 20.000 Bürger zur Inanspruchnahme der Richtlinien berechtigt sind, tatsächlich haben aber nur sehr wenige sie bislang in Anspruch genommen: Obwohl über 2000 Beratungen stattfanden, wurden in den ersten zwölf Monaten nur 300 individuelle Fälle eingereicht. Der Beitrag untersucht den Stand der Umsetzung der Richtlinien und vertritt die Auffassung, dass solcherlei informelle Mechanismen trotz ihrer anfänglichen „Kinderkrankheiten“ in einem funktionierenden Insolvenzrechtssystem eine wichtige Rolle spielen müssten. Sie gäben den modernen japanischen Insolvenzverfahren zusätzliche Flexibilität und spiegelten die globalen Tendenzen im Umgang mit in finanziellen Schwierigkeiten befindlichen Schuldern wider. Japans Gerichte bauten ebenso auf einer Tradition der flexiblen Lösung praktischer Probleme auf, die sich aus bestimmten Umständen der Insolvenz ergeben, was sich für die Opfer der Katastrophe positiv auswirken sollte. Gläubiger haben angesichts der Tatsache, dass sie rechtlich keinesfalls zur Zustimmung zu einer Reduzierung oder einem Erlass der Schuld verpflichtet sind, bei der Anwendung der Richtlinien wenig zu verlieren. Jedoch gibt es vereinzelte Berichte, nach denen Kreditinstitute Novationen individuell mit den Schuldern aushandeln und so vorteilhaftere Bedingungen erzielen, als sie im Rahmen der Richtlinien erreichbar wären. Möglicherweise werden sich Kreditinstitute in Zukunft mit gesellschaftlichem und politischem Druck konfrontiert sehen, die Katastrophenopfer über die Existenz der Richtlinien besser zu informieren und Ratenzahlungsvereinbarungen häufiger zuzustimmen.

(dt. Übers. durch d. Red.)