Cross border insolvency law: Reform and recent developments in light of the JAL corporate reorganisation filing

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Japan Airlines Corporation and certain subsidiaries (together, JAL) filed for corporate reorganisation under the Japanese Corporate Reorganisation Law on 19 January 2010. JAL’s filing presents an opportunity for the insolvency community to learn more about both the Japanese Corporate Reorganisation Law and the UNCITRAL Model Law on Cross Border Insolvency (Model Law). The JAL case has generated recognition of JAL’s corporate reorganisation proceedings as “foreign main proceedings” in the United States under the American implementation of the Model Law in Ch 15 of the US Bankruptcy Code, in the United Kingdom under the Cross Border Insolvency Regulations 2006, in Australia under the Cross Border Insolvency Act 2008 (Cth), and in Canada under the Companies’ Creditors Arrangement Act, RSC 1985, c C-36.

INTRODUCTION

During the 2000s, Japan implemented a suite of insolvency law reforms which are increasingly being used due to the collapse of Japanese corporations under the strain of the recent economic downturn.

Two important Japanese insolvency law developments are:

a) the enactment of the Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings1 (Japanese XB Law) in 2000, which implements the UNCITRAL Model Law on Cross-Border Insolvency2 (Model Law) in Japan; and

b) the revision of the Japanese Corporate Reorganisation Law3 (Reorganisation Law) in 2002.

The recent insolvency filing in respect of Japan Airlines Corporation, Japan Airlines International Co Ltd and JAL Capital Co Ltd (together, JAL) under the Reorganisation Law has put both of the above developments to an interesting test. On 19 January 2010, Mr Eiji Katayama and the Enterprise Turnaround Initiative Corporation of Japan (ETIC) were appointed as joint trustees under JAL’s corporate reorganisation proceedings.

This article briefly introduces the Reorganisation Law and the Japanese XB Law as examples of recent Japanese insolvency law reform. The key concept of “centre of main interests” (COMI) under the Model Law (which determines the jurisdiction of “foreign main proceedings” in international insolvencies) is reviewed together with recent case law which interprets the meaning of COMI. This is followed by a discussion of how JAL’s filing under the Reorganisation Law, and the recognition of JAL’s Japanese corporate reorganisation proceedings in the United States, the United Kingdom, Australia and Canada as “foreign main proceedings” under the various implementations of the Model Law in these countries, affects JAL’s foreign creditors.

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1 Law No 129 of 2000.

2 Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, GA Res 52/158, 52nd sess, 72nd plen mtg, Un Doc A/RES/52/158, annex (15 December 1997) (Model Law). To date, the Model Law has been implemented in Australia, British Virgin Islands, Canada, Colombia, Eritrea, Greece, Japan, Mauritius, Mexico, Montenegro, New Zealand, Poland, Republic of Korea, Romania, Serbia, Slovenia, South Africa, the United Kingdom and the United States of America.

3 The Kaisha Kosei Ho, Law No 154 of 2002.
THE REORGANISATION LAW AND JAPANESE CORPORATE REORGANISATION: AN OVERVIEW

The Reorganisation Law provides for a sophisticated, court-initiated, corporate rescue regime termed “corporate reorganisation”. The Reorganisation Law seeks to provide a mechanism to restructure a debtor’s business primarily through a restructuring plan promoted by either the reorganisation trustee, the debtor itself, creditors, or shareholders. The restructuring plan is voted upon by classes of stakeholders and then submitted to the court for final approval.

A debtor corporation (debtor) can petition for its own corporate reorganisation if:

a) it has committed or is on risk of committing an “act of bankruptcy” (that is, an event whereby the debtor could petition for its own bankruptcy under the Japanese Bankruptcy Act, which applies in Japan to both individuals and corporations); or

b) the debtor cannot repay its debts as they fall due without significant impediment to its continuation as a going concern. Alternatively, creditors owed debts which amount to more than 10% of the debtor’s paid-up equity capital, or shareholders holding more than 10% of issued voting shares, can petition for a debtor’s corporate reorganisation if the debtor has committed or is on risk of committing an act of bankruptcy.

The Corporate Reorganisation procedure is not a debtor-in-possession procedure. Rather, a “reorganisation trustee” (Trustee) is appointed to the debtor by the court. The Trustee is subject to supervision by the court, and is vested with the power to manage the debtor’s business and property, take control of the debtor’s assets, and propose a reorganisation plan for the debtor. The court has the discretion to place specific limitations on the Trustee’s powers in respect of the debtor and its business or assets.

Pending the court making a final order for the commencement of corporate reorganisation, the court has discretion to make an order for an interim moratorium to protect the debtor’s business, staying:

(i) the commencement of other insolvency proceedings against the debtor;

(ii) the enforcement of security interests and liens, or attachment and execution against the debtor’s assets; and

(iii) litigation and other proceedings against the debtor in relation to debts owed or its property. When the court makes a final reorganisation order, similar moratoriums apply to creditor actions against the debtor.

There is also a procedure for an “early restructure”, that is, before and instead of the proposal and approval of a reorganisation plan. The Trustee can apply to the court for approval to transfer all or a substantial part of the business of the debtor, for example, to a third-party purchaser. Both secured

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4 Corporate Reorganisation Law, Art 184(2).
5 Corporate Reorganisation Law, Art 17(1).
6 Corporate Reorganisation Law, Art 17(2).
7 A debtor-in-possession procedure is available to Japanese debtors under the Civil Rehabilitation Law (Law No 225 of 1999), which carries a possible moratorium on creditor action to allow a debtor to restructure, but is more creditor friendly and offers fewer tools to compromise creditors’ claims than the Corporate Reorganisation Law.
8 Corporate Reorganisation Law, Arts 67, 68, 72(1).
9 Corporate Reorganisation Law, Art 72(2).
10 Corporate Reorganisation Law, Art 24.
11 Corporate Reorganisation Law, Art 46(2).
and unsecured creditors and unions have the right to make submissions in respect of a proposed “early” business transfer by the Trustee, and shareholders controlling one-third of all voting rights can veto the transfer.

A reorganisation plan must divide stakeholders into classes, and provide equal treatment to stakeholders falling within each class. The classes of stakeholders are prescribed, being secured creditors, preferential unsecured creditors, unsecured creditors, subordinated unsecured creditors, preferred shareholders, and ordinary shareholders. Each stakeholder class votes separately on the restructuring plan, although the court has discretion to adjust classes for voting purposes, including to increase the number of classes.

Once stakeholders have voted on the plan, the court then decides whether to approve the plan. In deciding, the court must consider:

a) the voting outcomes and procedure; and
b) whether the plan is fair and equitable, and capable of implementation.

The court can approve the plan even if it is not passed by all classes of stakeholders. However, if the plan has been rejected by either unsecured creditors or secured creditors then the court must provide for some form of “adequate protection” for the rejecting class in the reorganisation plan in order for the court to have jurisdiction to approve the reorganisation plan.

Upon approval by the court, the reorganisation plan extinguishes the claims of all unsecured and secured creditors, and shareholders, and replaces their rights with the rights (if any) conferred upon them under the plan.

A reorganisation plan is therefore capable of effecting a comprehensive restructure of the debtor’s balance sheet.

THE MODEL LAW

The Model Law has been developed by the United Nations Commission on International Trade Law (UNCITRAL) to achieve greater efficiency, structure and certainty in cross-border insolvency cases.

The Model Law, and naturally the Japanese XB Law which implements it in Japan, essentially provide choice of applicable law and jurisdiction (forum) regimes for particular aspects of insolvency proceedings of debtors with international assets and operations.

The Model Law must be implemented into local law. For example, Japan has implemented the Model Law into Japanese domestic law under the Japanese XB Law.

A “collective” insolvency proceeding is one which seeks to consider the rights and obligations of all (or most) creditors of a debtor (relevant to Australian and English law is that receivership is not a collective proceeding for Model Law purposes in Australia or England, although receivership in other countries differs and may be eligible to be a collective proceeding). Collective insolvency proceedings which are opened in the jurisdiction of a debtor’s COMI become the “foreign main proceedings” of
Foreign main proceedings may be recognised as such in those foreign jurisdictions which have implemented the Model Law and in which an application for recognition of the foreign main proceeding has been made.

The concepts of COMI and “foreign main proceedings” under the Model Law are therefore key, and discussed in turn below.

**FOREIGN MAIN PROCEEDINGS UNDER THE MODEL LAW**

Foreign main proceedings are given leading status under the Model Law as follows.

**“Obligatory” recognition of foreign main proceedings in other Model Law countries upon application for recognition**

In jurisdictions where the Model Law’s terms are “faithfully” implemented into local law, the foreign main proceedings of a debtor must be recognised if an application for recognition is made and the (largely procedural) conditions of recognition are satisfied. The fact that recognition of foreign main proceedings is obligatory or mandatory upon application for recognition emerged clearly in *Hur v Samsun Logix Corp* (*Samsun Logix*).

In *Samsun Logix*, Korean receivership proceedings (receivership is a collective insolvency proceeding in Korea) commenced in Korea (the COMI of the debtor) were recognised both in Australia and the United Kingdom.

The Model Law here differs from the pan-European cross-border cooperation regime for European cross-border insolvencies under the EC Regulation. Recognition of foreign main proceedings in other Model Law jurisdictions requires an application for recognition in other relevant Model Law countries. By contrast, under the EC Regulation, once “main proceedings” are commenced in one member state, they automatically apply without application for recognition in other member states.

In cases where the Model Law has not been faithfully implemented into local law, such as in Japan (as will be seen below), recognition of foreign main proceedings may be at the discretion of the court considering the application for recognition.

**Automatic limited moratorium protection against creditor action applies upon recognition**

In jurisdictions which have implemented the Model Law faithfully, upon recognition of foreign main proceedings, an automatic limited “winding-up-style” moratorium applies to protect the debtor from local creditor action in the jurisdiction of recognition. That is, legal proceedings against the debtor are stayed, disposals or encumbrances of assets by the debtor are stayed, and execution against the debtor’s assets is stayed. However, enforcement of proprietary security interests, set-off and termination of contracts are typically not stayed unless further discretionary relief is sought (see discussion below).

Wider moratorium protection may be available in the various jurisdictions at the discretion of the local courts, depending upon the remedies available under the local law in question. For instance, in Australia under Australia’s implementation of the Model Law – the *Cross Border Insolvency Act 2008* (Cth) (Australian XB Law) – and in England under the English implementation of the Model Law – the *Cross Border Insolvency Regulations 2006* (UK) (UK XB Law) – an “administration-style” moratorium does not automatically apply upon recognition of foreign main proceedings but is

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20 Model Law, n 2, Art 2(a), (b).
21 *Hur v Samsun Logix Corp* [2009] FCA 372. The recognition of Korean receivership proceedings as foreign main proceedings in various jurisdictions including Australia (under the *Cross Border Insolvency Act 2008* (Cth)) and the United Kingdom (under the *Cross-Border Insolvency Regulations 2006* (UK)) in *Samsun Logix* showed how both jurisdictions (Australia and the United Kingdom), which have implemented the Model Law into local law faithfully to its terms, acknowledged that recognition is mandatory, not at the discretion of the court considering an application for recognition, if the foreign proceedings in question are “collective proceedings” commenced in the jurisdiction of the debtor’s COMI, and other procedural and evidentiary requirements are satisfied. For the United Kingdom recognition, see *Re Samsun Logix Corp* [2009] EWHC 576 (Ch).
available upon request in the court’s discretion as additional relief. An administration-style moratorium is wider because it also stays the enforcement of security interests, though not set-off or termination of contracts. Administration-style moratorium relief was applied for and granted in the Samsun Logix case by the Australian and English courts, but does not seem to have been requested in relation to JAL in Australia (see below).

Realisation, administration and turnover/distribution of local assets

Foreign main proceedings, upon the application by the foreign representative (foreign liquidator/administrator/trustee etc) in the foreign main proceedings (for example, the JAL Trustee), can be empowered to govern many aspects of the administration of the debtor’s insolvent estate worldwide.

The Model Law grants discretion to local courts in jurisdictions in which foreign main proceedings have been recognised to empower the foreign representative to administer local assets, realise local assets and turnover realisation proceeds back to the jurisdiction of foreign main proceedings for distribution.23

However, before turning over local assets or realisation proceeds to foreign main proceedings for distribution to creditors, the Model Law requires that the local court must be satisfied that local creditors are or will be “adequately protected”.24 The Model Law is concerned here to ensure that local assets are not turned over to a foreign main proceeding, away from local creditors, unless local creditors either can prove in the foreign main proceedings for a distribution, or are otherwise “adequately” protected. The matter of “adequate protection” is not defined under the Model Law, but it appears to pick up the idea of “adequate protection” under the US Bankruptcy Code 11 USC § 61 (which may assist in determining issues of “adequate protection” when they arise under the Model Law).

In exercising its discretion on the matter of turnover, a local court may wish to refer to its own conflicts of laws principles to determine whether local assets would normally be turned over for distribution to foreign main proceedings. This, of course, leaves much room for varied results. For instance, under English and Australian common law relating to cross-border insolvency, the distinction between “main liquidations” (usually liquidations commenced in the jurisdiction of incorporation or domicile of the debtor company) and “ancillary liquidations” (usually in a jurisdiction where assets of the debtor are located) has long been recognised. An ancillary liquidation in England always applies English law to matters in the ancillary liquidation.25 That is not to say an English court in an ancillary English liquidation would not turnover assets to a foreign main liquidation (since English courts have often done this),26 but rather shows that where discretion and local law apply, the scope for varied outcomes is large.

The fact that the Model Law conditions the turnover of local assets to a foreign main proceeding upon local creditors being “adequately protected” has the potential to raise various obstacles to the turnover of assets and cooperation. Turnover has been inhibited in past cross-border insolvency cases where laws of set-off etc, differ upon insolvency in the respective jurisdictions in question, such that the treatment of creditors upon the debtor’s insolvency in one jurisdiction (which, for example, permits an insolvency set-off) differs from the other jurisdiction (which may not permit an insolvency set-off).27

23 Model Law, n 2, Art 21.
24 Model Law, n 2, Art 21(2).
26 For recent statements of principle relating to main and ancillary liquidation, see McGrath v Riddell [2008] UKHL 21, discussed in n 274.
27 This issue (a difference in the application of set-off upon insolvency) was enough to prevent a turnover of assets from an English ancillary liquidation to a Luxembourg main liquidation under pre-UNCITRAL general common law principles of comity (cooperation) in Re Bank of Credit & Commerce International SA (No 10) [1997] Ch 213. However, a similar issue of the differing treatment of insurance proceeds upon the onset of insolvency (whether ring-fenced for the creditor-beneficiaries of the
Equal access by foreign creditors worldwide to foreign main proceedings

If the Model Law is implemented faithfully into local law, foreign creditors worldwide are granted access to foreign main proceedings and can vote, receive information and receive distributions alongside domestic creditors. Access to foreign main proceedings by local creditors may be one factor that assists local courts to determine that local creditors are “adequately protected” when considering whether to exercise their discretion to turnover local assets to a foreign main proceeding.

COMI under the Model Law

Given the importance of COMI in determining the jurisdiction of a debtor’s “foreign main proceedings”, it is worth spending some time considering recent case law developments on the meaning of COMI.

A debtor’s COMI is not necessarily in its jurisdiction of incorporation. The Model Law and the EC Regulation alike look to the substance of a debtor’s operations, and entertain the possibility that a debtor may “grow out” of its jurisdiction of incorporation through expansion overseas. The jurisdiction in which a debtor’s COMI lies determines the jurisdiction in which main insolvency proceedings may be commenced, regardless of whether this jurisdiction is the jurisdiction of incorporation.

COMI is not defined under the Model Law, nor under the EC Regulation where the phrase COMI is used in the same way and for the same purpose. The Model Law and the EC Regulation both provide that COMI is presumed to be in the location of the debtor’s registered office in the absence of proof to the contrary. However, the EC Regulation is slightly more helpful than the Model Law because Recital 13 of the EC Regulation provides that COMI “should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties”.

Recent English case law on the meaning of COMI under the UK XB Law is particularly helpful. In *Re Stanford International Bank Ltd* ([Stanford](http://example.com)), which has been confirmed on appeal, the court confirmed a number of key points relating to the meaning of COMI:

(a) COMI is the same under the EC Regulation and the UK XB Law – the meaning of COMI under the European cross-border insolvency regime under the EC Regulation is the same as COMI under the UK XB Law, which implements the Model Law very faithfully to its terms.

(b) COMI is presumed to be the location of the debtor’s registered office – the Model Law and the EC Regulation alike provide that COMI is presumed to be in the location of the debtor’s registered office. This presumption can be rebutted but:

(i) the onus lies upon the party seeking to rebut the presumption to prove otherwise; and

(ii) critically, the evidence permitted to make the rebuttal is restricted to information from which COMI could be “objectively, reasonably ascertained” by third parties dealing with the debtor – see paragraph (e) below for further discussion.

(c) In corporate groups, COMI is determined entity-by-entity – in corporate groups COMI is determined on an entity-by-entity basis. In relation to parent and subsidiary companies, the fact
that a parent company has the potential to influence board decisions of the subsidiary by appointing directors, or to influence a subsidiary though control of its general meetings, will not itself mean that the subsidiary and the parent have common COMIs; rather, the COMI of the subsidiary itself should be considered discretely on its merits.\(^{(32)}\)

(d) **COMI essentially means “head-office function”** – in respect of the UK XB Law, assistance in interpreting the term COMI can be garnered from Recital 13 of the EC Regulation, which provides that COMI “should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties”. That is, the COMI test is a “head-office functions test”, which means that one must look to where the debtor’s “head-office functions” are conducted.

(e) **COMI is where a reasonable bystander would consider the “head-office functions” to be (not where they are) – critically, and here lies the importance of the *Stanford* decision, the “head-office functions test” must be applied on an objective and transparent basis, meaning that what is important is what the court called “ascertainability”**.

The “COMI question” is: in which jurisdiction would third parties reasonably consider the head-office functions of the debtor to be conducted, based upon information and marketing materials in the public domain and from information obtained from dealings with the debtor? The court in *Stanford* emphasised the importance of objective predictability in respect of COMI – COMI is where the reasonable person dealing with the debtor thinks the debtor conducts its head-office functions, not where the debtor actually conducts them.\(^{(33)}\)

*Stanford*’s emphasis on the need to judge COMI from the outside, by what third parties would consider to be the debtor’s COMI, is driven by a recognition that creditors need certainty when lending or extending credit. Certainty is created by allowing creditors to predict reliably the forum of a debtor’s main insolvency proceeding in order to assess and price properly the risks of making a loan or extending credit to a debtor.

*Stanford* referred to perhaps the first case dealing with COMI under the EC Regulation, *Re Eurofood IFSC Ltd* [2006] Ch 508 (*Eurofoods*). *Eurofoods* likewise emphasised that if the presumption that COMI lies in the jurisdiction of a debtor’s registered office is to be rebutted, that rebuttal must be premised on factors which are both objective and ascertainable by third parties. *Stanford* confirms that the test of “ascertainability” for COMI can be traced back to *Eurofoods*. The court in *Stanford* noted that this requirement of “ascertainability” of COMI probably does not differ from the American test of COMI under the implementation of the Model Law under Ch 15 of the *US Bankruptcy Code*. The American authorities also refer to determining COMI by “objective factors ascertainable to third parties”, albeit the application of this test in the United States to date may not have placed quite the same degree of emphasis upon COMI being ascertainable by third parties as in *Stanford*.\(^{(34)}\)

(f) **COMI is determined from public domain and marketing materials, location of business licences, and location of administrative and management staff** – *Stanford* confirms that the factors to be considered to objectively determine the jurisdiction of the head-office functions of a debtor are materials in the public domain, or made available to third parties dealing with the debtor, such as advertising and marketing materials, the jurisdiction which the debtor uses/chooses to govern its contracts and disputes, the jurisdiction in which the debtor holds its principal business licences, and the location where the majority of the debtor’s administrative and management staff are located.\(^{(35)}\)

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\(^{(32)}\) See *Re Stanford International Bank Ltd* [2009] EWHC 1441 (Ch) at [60], citing *Re Lennox Holdings plc* [2009] BCC 155.

\(^{(33)}\) See *Re Stanford International Bank Ltd* [2009] EWHC 1441 (Ch) at [61], [62].

\(^{(34)}\) *Re Stanford International Bank Ltd* [2009] EWHC 1441 (Ch) at [67], citing the American authority of *Re Sphinx Ltd* 351 BR 103 (2006).

\(^{(35)}\) *Re Stanford International Bank Ltd* [2009] EWHC 1441 (Ch) at [62].
Stanford also goes some way to prevent “COMI structuring” – the practice of a debtor and its advisors trying to change the jurisdiction of a debtor’s COMI in the last months leading up to an insolvency filing to “forum shop” for foreign main proceedings in a jurisdiction which is favourable to the debtor’s contingency planning.

Stanford’s approach of adopting one uniform meaning for COMI as between the EC Regulation and the UK XB Law is attractive. Indeed, if each Model Law country interprets COMI differently, the benefits of having relatively uniform Model Law implementation start to diminish.

Stanford is likely to be followed by courts interpreting the meaning of COMI in other jurisdictions, especially common law jurisdictions. Although Stanford, as an English case, applies to the UK XB Law, it makes good commercial sense and offers an interpretation of COMI which allows creditors a high degree of certainty in predicting a debtor’s COMI for the purposes of the Model Law.

The Australian Federal Court did not cite or refer to Stanford in the Australian recognition of JAL’s corporate reorganisation proceedings as foreign main proceedings. The Australian Federal Court clearly recognised (in common with Stanford) that COMI is a “head-office functions” test, and that the location of key decision-making, administrative functions, employees and assets, are relevant to determine COMI. However, the Australian court did not venture into the question of whether COMI is determined by where COMI actually is, or where it would appear to be to third parties dealing with the debtor (the objective ascertainability element of COMI emphasised in Stanford).

The subsequent Australian Federal Court decision in Ackers v Saad Investments Co Ltd has, however, expressly followed Stanford. Ackers emphasises the importance of having an objectively ascertainable basis to allow creditors reliably to predict the jurisdiction of a debtor’s foreign main proceedings. Ackers involved the application for recognition in Australia as foreign main proceedings of Cayman Islands liquidation proceedings.

THE JAPANESE XB LAW

Japan implemented the Model Law in 2000 – much earlier than most other countries – by passing the Japanese XB Law.

The definitions and treatment under the Japanese XB Law of:
a) COMI;
b) the recognition of foreign main proceedings;
c) moratoriums upon creditor action in Japan upon recognition of foreign main proceedings; and
d) the administration, realisation, and turnover of assets in Japan to foreign main proceedings elsewhere in the world for distribution,

show that Japan has not implemented the Model Law as faithfully as, for example, Australia in the Australian XB Law and the United Kingdom in the UK XB Law. Rather, the Japanese XB Law is a slightly “Japanised” version of the Model Law compared with the implementation of the Model Law in Australia and the United Kingdom.

Discretions reserved to the Japanese courts under the Japanese XB Law

In particular, Japanese courts appear to be reserved certain discretions as regards:
(i) recognition of foreign main proceedings commenced in the jurisdiction of a debtor’s COMI – recognition is not obligatory or mandatory;
(ii) the grant of moratoriums upon creditor action in Japan upon the recognition of foreign main proceedings in Japan – moratoriums are not automatic, as will be shown below; and
(iii) permission to administer, realise and turnover to foreign main proceedings assets which are located in Japan.

Each of these matters is discussed in turn below.

37 See Katayama v Japan Airlines Corp (2010) 79 ACSR 286 at [25].
38 Ackers v Saad Investments Co Ltd [2010] FCA 1221 at [44], [49].
These discretions of the Japanese courts and the dearth of cases interpreting the Japanese XB Law make its application difficult to predict with certainty.

**COMI under the Japanese XB Law**

A literal translation into English of COMI as it is described in the Japanese XB Law is the debtor’s “principal place of business”. This is faithful to the definition of COMI under the Model Law in the sense that the emphasis is upon where the debtor’s main business function is conducted, rather than the debtor’s jurisdiction of incorporation.

There does not appear to be any Japanese case law interpretation of the definition of COMI. It remains to be seen whether Japanese courts will find the Stanford decision or other case law of foreign jurisdictions helpful in interpreting the meaning of COMI. Given that the Japanese definition of COMI is simply the debtor’s “principal place of business”, the same issues are likely to arise in determining COMI as have arisen in other countries. Namely, whether some level of objective ascertainability is required, or alternatively whether the focus should be on where the debtor’s principal place of business actually is (not where it appears to be). For now, these questions remain open.

**“Foreign main proceedings” under the Japanese XB Law: Recognition**

Foreign main proceedings commenced outside Japan in the jurisdiction of a debtor’s COMI can be recognised in Japan under the Japanese XB Law upon application to the court. However, the Japanese XB Law departs from the Model Law in that such recognition is subject to a number of substantive conditions and could not be said to be “mandatory” upon application by a foreign representative in collective insolvency proceedings commenced in the jurisdiction of a debtor’s COMI. For example, where Japanese domestic insolvency proceedings have been commenced first, or are commenced after foreign main proceedings in relation to the same debtor, foreign main proceedings can only be recognised, or continue to be recognised, in Japan if the court considers that their recognition “accords with the general interests of creditors” and that Japanese domestic creditors would not be unfairly prejudiced by the recognition.

These domestically focused conditions, and the Japanese courts’ role in considering them, position the courts between recognition of foreign main proceedings and the applicant. Accordingly, recognition cannot be said to be obligatory, mandatory or automatic. This is largely untested territory and it is difficult to predict how the Japanese courts will interpret and implement these provisions of the Japanese XB Law. However, there is potential for Japanese courts to refuse Japanese recognition of foreign main proceedings commenced outside of Japan in countries which have implemented the Model Law.

**“Foreign main proceedings” under the Japanese XB Law: Moratoriums upon creditor action in Japan upon recognition**

Wide-ranging moratoriums are available under the Japanese XB Law to stay action in Japan by Japanese domestic creditors or otherwise, including stays on:

a) proceedings against the debtor;
b) execution against and attachment of the debtor’s assets in Japan;
c) disposals of assets and the repayment of creditors; and
d) the enforcement of security interests.

However, none of these moratoriums – not even limited “winding-up-style” moratoriums against

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39 COMI is referred to in the definition of “foreign main proceedings” in Art 2(2) of the *Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings*.


disposals of assets, repayment of creditors and the commencement of court proceedings – follow automatically upon the recognition of foreign main proceedings in Japan.

Instead, all moratoriums are subject to a further layer of Japanese court discretion, and are only available if the court considers that the moratorium in question is necessary to achieve the purposes of the foreign main proceedings. In the case of moratoriums upon enforcement of security interests, these are only available where the moratorium would be consistent with the general interests of creditors. Again, this is largely untested territory and it is difficult to predict how Japanese courts will apply the moratorium provisions upon the recognition of foreign main proceedings in Japan.

Realisation, administration and turning over of local (Japanese) assets

A foreign (non-Japanese) debtor’s assets located in Japan can be realised and administered and turned over to a foreign main proceeding outside Japan, upon the recognition of foreign main proceedings in Japan. The Japanese XB Law achieves this through the appointment of a “trustee” to administer and realise the debtor’s assets located in Japan (Realisation Trustee). The Japanese XB Law appears to be unclear whether the Realisation Trustee is or can be the foreign representative in the foreign main proceedings (a non-Japanese person), or must be a Japanese domestic trustee.

The Realisation Trustee appointed upon the recognition of foreign main proceedings in Japan has the power to conduct the debtor’s business, and to administer and dispose of the debtor’s assets. However, a Realisation Trustee needs the consent of a Japanese court to dispose of the debtor’s Japanese domestic assets, and to turnover assets or realisation proceeds to the foreign main proceedings outside Japan for distribution. A Japanese court can only authorise turnover if it determines that there is no risk that Japanese domestic creditors would thereby be unfairly prejudiced.

The Japanese XB Law is here relatively faithful to the Model Law, which as noted above, requires that the interests of local creditors be adequately protected upon the turnover of assets from a local jurisdiction to the jurisdiction of the foreign main proceeding.

Access to Japanese proceedings by foreign creditors

One element of the Model Law which has certainly been implemented without change under the Japanese XB Law is the matter of equal access by foreign creditors worldwide to foreign main proceedings. Foreign main proceedings commenced in Japan in relation to a debtor with a Japanese COMI grant full access and equal rights to foreign creditors to participate in the Japanese main insolvency proceedings. Such creditors may, for example, receive information such as reports to creditors, vote on reorganisation or other restructuring plans, and receive distributions.

45 See, eg Arts 25 and 26 of the Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings, which give a Japanese court discretion whether or not to grant a moratorium on certain creditor action in Japan upon an application for recognition of foreign main proceedings in Japan – namely, any moratorium on any creditor action appears not to be automatic upon recognition, rather it is at the court’s discretion. By contrast, under the Model Law, if (largely procedural) conditions for recognition of foreign main proceedings apply, a limited “winding-up-style” moratorium on certain creditor action applies automatically, and there is scope for that moratorium then to be extended at the court’s discretion – see discussion above.

46 Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings, Art 27.

47 Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings, Art 32.

48 Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings, Art 34.

49 Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings, Art 35.

50 Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings, Art 35(2).

51 The equal status of foreign creditors is confirmed in both Art 3 of the Corporate Reorganisation Law and Art 3 of the Law Relating to Recognition and Assistance for Foreign Insolvency Proceedings.
WHAT DOES JAL’S FILING UNDER THE REORGANISATION LAW MEAN FOR FOREIGN CREDITORS?

This section builds on the background above, and uses the example of JAL’s filing under the Reorganisation Law to discuss and illustrate some of the ramifications of a Japanese corporate reorganisation filing for foreign creditors.

The discussion in this section is not all based on the actual circumstances of the JAL case. Instead, much of the discussion in this section takes the JAL reorganisation as a theoretical example of a Japanese corporate reorganisation case that has been recognised as foreign main proceedings in other Model Law jurisdictions outside Japan to illustrate how the Model Law, the Reorganisation Law and the Japanese XB Law operate.

JAL’s COMI

JAL, being Japan’s major airline, and operating flights which largely originate from Japan (although JAL’s operations are worldwide), is almost certainly going to have its COMI in Japan for Model Law purposes. This was confirmed upon the recognition of JAL’s corporate reorganisation proceedings in the United States under Ch 15 of the US Bankruptcy Code. The United States Bankruptcy Court had no hesitation in finding that JAL’s COMI is located in Japan in Re Japan Airlines Corp.52

Japanese corporate reorganisation proceedings as “collective proceedings”:
The possibility of recognition of JAL’s corporate reorganisation proceedings in other Model Law countries as foreign main proceedings

Japanese corporate reorganisation proceedings for JAL and its subsidiaries have been held to be “collective proceedings” and so capable of recognition (if required) as “foreign main proceedings” in other jurisdictions where JAL has assets or operations and which have implemented the Model Law. Only “collective” insolvency proceedings, which administer the claims of all or most creditors of the debtor, are eligible for recognition as foreign main proceedings under the Model Law. Accordingly, JAL’s reorganisation proceedings in Japan have had access to the Model Law’s assistance, including moratoriums on creditor action, suspensions on transfers of assets, and administration and realisation of local assets, albeit subject to reservations made in the relevant jurisdictions to protect local creditors.

Recognition as foreign main proceedings in the United States under Ch 15 of the US Bankruptcy Code

One of the first applications for the recognition of JAL’s Japanese corporate reorganisation proceedings as foreign main proceedings in another Model Law country was the application for recognition in the United States. The application was granted under Ch 15 of the US Bankruptcy Code. An automatic effect of recognition of foreign main proceedings under this law is that the automatic stay that applies under the US Bankruptcy Code 11 USC § 62 applies to JAL’s assets in the United States to protect JAL from creditor enforcement action there.53 Further, JAL’s Trustee, as foreign representative, has been granted the power to examine witnesses in the United States, and to administer and realise JAL’s assets located there. However, JAL’s Trustee does not appear to have been granted permission to turnover American local assets to the Japanese foreign main proceedings.

53 US Bankruptcy Code, 11 USC § 1520 applies the automatic stay in § 362 upon the recognition of foreign main proceedings in the United States.
to turnover on the basis that local creditors are “sufficiently protected” – this is a faithful implementation (under Ch 15 of the US Bankruptcy Code) of the Model Law provisions relating to turnover of assets.\(^{54}\)

**Recognition in the United Kingdom and Australia as foreign main proceedings**

JAL’s Japanese corporate reorganisation proceedings have also been recognised as foreign main proceedings in the United Kingdom and Australia.

In Australia, application was made to the Federal Court of Australia for recognition as foreign main proceedings and associated orders, which were granted on 30 June 2010.\(^{55}\) The recognition in the United Kingdom does not appear to be the subject of a reported judgment.

JAL’s Japanese corporate reorganisation proceedings were recognised in Australia as foreign main proceedings, and in addition the administration and realisation of all JAL’s assets located in Australia have been entrusted to JAL’s Trustees. No order was sought or made authorising JAL’s Trustees to turnover or distribute JAL’s Australian assets to JAL’s Japanese corporate reorganisation proceedings (foreign main proceedings).

**Contracts with trade counterparties/creditors: Termination or avoidance**

Under the Reorganisation Law, the Trustee has the discretion either to terminate executory (unperformed) contracts to which the debtor is party, or affirm them and seek performance against the counterparty.\(^{56}\) It is unclear whether the Reorganisation Law prohibits creditors from exercising rights under clauses permitting termination of contracts on insolvency grounds, and whether the Trustee’s apparent right to seek performance of executory contracts against counterparties effectively prohibits such “termination on insolvency” or “ipso facto” clauses. This point should, if relevant, be considered carefully in the prevailing circumstances. Contract counterparties can serve notice on the Trustee requiring a decision by the Trustee within a “reasonable time” on whether he/she will terminate or affirm their contract, and the Trustee is deemed to affirm the contract if he/she does not respond within the stipulated timeframe.\(^{57}\)

JAL’s Trustee therefore has the ability to terminate contracts with JAL’s counterparties. Should they do so, termination would be effective in Japan. However, it is not clear what the effect would be of the termination by the JAL Trustee of a contract with a foreign (non-Japanese) counterparty. The answer is likely to differ on a case-by-case basis depending on the conflicts of laws principles relevant to the contract and the applicable law of the contract. The Model Law does not appear to deal with contracts and their termination – this is left to the general law.

Assume for discussion purposes that the JAL Trustee terminates a contract with an Australian counterparty. Assume also that the contract in question is governed by Australian law or otherwise has a sufficient connection with Australia to found jurisdiction of Australian courts to entertain a contractual matter. The Australian counterparty could consider its right to sue in Australia for damages arising from the unanticipated termination, and seek to execute any judgment obtained for damages against assets of the JAL entity in Australia. However, it is possible, but not clear, that Australian conflicts of laws principles as relevant to insolvency would defer to Japan as the forum of the

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\(^{54}\) See *US Bankruptcy Code* 11 USC § 1521(b), which permits an American court to authorise a foreign representative in a foreign main proceeding which has been recognised in the United States, to turnover assets of a debtor located in the United States, and make distributions to American creditors.


\(^{56}\) *Corporate Reorganisation Law*, Art 61.

\(^{57}\) *Corporate Reorganisation Law*, Art 61(2).
insolvency to determine the validity of the termination. 58 This is not an easy question and the matter does not appear to be dealt with under the Model Law. The recognition in Australia of JAL’s corporate reorganisation proceedings as foreign main proceedings under the Australian XB Law would stay any (unsecured) creditor action to sue and obtain judgment for damages or debts due and the execution of the judgment against JAL’s assets in Australia. The only remaining option for the Australian creditor in this example would be to prove the claim in the Japanese reorganisation (the foreign main proceeding). As noted above, the Reorganisation Law and the Japanese XB Law allow foreign creditors to participate in Japanese reorganisation proceedings.

Payments of accrued claims under existing contracts with “small” trade counterparties/creditors

Upon the making of a reorganisation order, payment or other satisfaction by the Trustee of any creditor’s existing unpaid claims against the debtor (incurred before the reorganisation order was made) is generally prohibited. 59 An exception is that the Japanese court can authorise the Trustee to make payments to important SME (small/medium-sized enterprises) trade creditors and counterparties where non-payment of accrued claims would create significant difficulty for the continuation of the debtor’s business. 60 Significant difficulty would likely exist for these purposes if the counterparty in question refuses to contract further with or supply services to the Trustee or debtor, without payment of existing debts.

It would appear from press articles that a significant amount of “warming up” of the Japanese District Court was conducted to lay the groundwork for an application by JAL’s Trustee to approve payments to key trade creditors and counterparties upon the filing for corporate reorganisation by JAL and its subsidiaries. 61 whether such counterparties were small or large. This was apparently in order to give JAL the ability to pay accrued claims to all of its creditors to avoid creditor enforcements. Even large creditors appear to have been wrapped into payments by the JAL Trustee, stretching the Reorganisation Law, to ensure JAL can continue to pay creditors and so trade through its reorganisation period.

Could creditors assert rights of set-off against JAL?

The Reorganisation Law permits the set-off of mutual claims incurred before the earlier of either the time a creditor has notice of the debtor’s insolvency (defined as the debtor being generally unable to pay its debts as they fall due) 62 or the making of a reorganisation petition. This may occur where a valid set-off agreement exists, or whether set-off would be permitted at general law. 63 The set-off must be conducted before the end of the period allowed for proof of claims in the reorganisation. 64

It appears that under the Reorganisation Law creditors cannot, with knowledge of a debtor’s insolvency, acquire claims or liabilities against a debtor in order to “construct” a set-off against the debtor already under reorganisation, or an insolvent debtor which later enters reorganisation. 65 An exception appears to be where the creditor has an existing contractual arrangement with the debtor under which claims are acquired (a standing receivables purchase arrangement would seem to meet this

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58 This is a difficult question. For a helpful explanation of the application of conflicts of laws principles in international insolvencies from an Anglo-Australian perspective, see Goode R, Principles of Corporate Insolvency Law (3rd ed, Sweet & Maxwell, 2005) pp 632-634. This passage emphasises the importance of the forum (jurisdiction of insolvency proceeding) when deciding which law is to determine the treatment of existing rights upon an insolvency.

59 Corporate Reorganisation Law, Art 47(1).

60 Corporate Reorganisation Law, Art 47(2).

61 See the article in the Daily Yomiuri Online, entitled “Flexibility Critical to JAL Bailout/Applying Rehabilitation Law Flexibly Key to Ensuring Airline’s Services, Safety”.

62 Corporate Reorganisation Law, Art 49(2).

63 Corporate Reorganisation Law, Art 48, read with Arts 49, 49-2.

64 Corporate Reorganisation Law, Art 48.

65 Corporate Reorganisation Law, Arts 49, 49-2.
exception) and acquires the claims before a reorganisation order is made. Conducting a set-off like this is likely to be highly fact-specific and would require careful analysis in the circumstances.

Accordingly, it seems that JAL’s creditors would at least benefit from set-off rights against JAL in respect of mutual claims incurred before the earlier of the date they had notice of JAL’s insolvency, and the making of JAL’s reorganisation petition (19 January 2010).

Can creditors enforce their claims or security interests against JAL?

JAL’s corporate reorganisation proceedings stay the enforcement of security interests against JAL in Japan.

The enforcement of security interests against JAL in other jurisdictions by JAL’s foreign secured creditors depends upon the implementation of the Model Law in those jurisdictions, particularly in relation to the recognition of foreign main proceedings and the application of moratoriums upon recognition of foreign main proceedings. For example, in the United States, the corporate reorganisation proceedings in Japan were recognised as foreign main proceedings and, as noted above, moratoriums upon enforcement of security interests by American creditors were granted. The Australian recognition (could have but) does not grant a moratorium upon the enforcement of security interests in Australia (an administration-style moratorium) – rather, only a winding-up-style moratorium has been granted in Australia.

If the JAL Trustee desires any further recognitions and/or moratoriums in other Model Law jurisdictions, then any discretions reserved to local courts (as is the case in Japan under the Japanese XB Law) as regards recognition of foreign main proceedings and the application of moratoriums upon recognition will be very important considerations for the Trustee.

How would creditors participate in Japanese reorganisation proceedings, vote on restructuring plans, prove for their debts and receive distributions?

Where creditors find themselves with claims against JAL or its subsidiaries which are subject to Japanese reorganisation proceedings, the Japanese XB Law and the Reorganisation Law both grant foreign creditors equal access to those proceedings with domestic Japanese creditors. Foreign creditors should receive all the notifications and communications to creditors (reports, invitations to prove claims etc) that domestic Japanese creditors receive, and be able to exercise creditors’ rights such as voting upon a restructuring plan, and proving their claims and receiving distributions.

Thus, the JAL Trustee appears to have involved JAL’s foreign creditors in the corporate reorganisation process by permitting foreign creditors (outside Japan) to lodge proofs of claims and participate in the voting process and reorganisation plan.

JAL’s reorganisation plan

The reorganisation plan for JAL was submitted to two classes of creditors for voting: secured creditors and unsecured creditors. It is not clear why shareholders where not established as a voting class under the reorganisation plan. This is presumably because there was no real economic interest remaining for shareholders. If this is correct, then the ability to “leave behind” a class of stakeholders that has no real economic interest going forward is a powerful remedy.

The reorganisation plan was approved by the Japanese District Court on 30 November 2010. The key elements of JAL’s reorganisation plan include:

a) **Merger of three JAL entities** – the three JAL entities in corporate reorganisation would be merged into one entity, called Japan Airlines International Co Ltd (JAICL).

b) **Recapitalisation** – all existing shareholder rights and claims are extinguished, and the ETIC would subscribe for 350 billion yen worth of new shares in JAICL to recapitalise it. The ETIC thereby becomes the new 100% shareholder of JAICL.

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66 Corporate Reorganisation Law, Arts 49, 49-2(2) (items 1 and 4).
c) **New business plan** – a new business plan would be adopted, involving cutting unprofitable routes, and reducing its fleet by approximately 40% and its workforce by approximately 30%. There is also the possibility of JAICL establishing a low-cost carrier (LCC) arm, possibly based on Qantas’s Jetstar model.

d) **Majority write-off of unsecured claims** – the write-off of 87.5% of unsecured claims, with the remainder owing (12.5%) to be rescheduled and paid in annual instalments over seven years. The majority of unsecured claims against JAL were apparently held by financial institutions which had lent to JAL on an unsecured basis.

e) **Rescheduling of secured claims** – debt secured against assets which JAL would continue to use would be preserved in full, and rescheduled to be repayable over six to seven years. For debt secured over other, less important assets, JAL would attempt to sell the assets under certain timelines, failing which these secured claims would be rescheduled as for other secured claims.

f) **Refinancing of secured debt** – JAICL would seek to refinance both its remaining unsecured and secured debt as soon as possible.

g) **Reduction of pension liabilities** – JAL operates a defined-benefit pension scheme into which JAL makes contributions. Approval from pension fund beneficiaries, and the relevant Minister, would be sought to reduce pension benefits to scheme members by between 30-50%.

A large degree of pre-negotiation of elements of JAL’s reorganisation plan is rumoured to have been conducted with key stakeholders to ensure creditor support for the plan.

The key features of JAL’s reorganisation plan include significant write-offs and rescheduling of JAL’s unsecured and secured debt respectively, and a radical transformation of JAL’s business plan. The plan is likely to be a step in the right direction for JAL. It will be crucial for JAL to have achieved sufficient deleveraging under the plan to avoid needing an injection of further debt or equity in the short term.

It will be interesting to see whether the reorganisation plan becomes the subject of further applications for recognition in jurisdictions other than the United States, the United Kingdom, Canada and Australia, whether under the Model Law or other cross-border insolvency cooperation regimes.

**CONCLUSION**

The filing by JAL for Japanese corporate reorganisation under the Reorganisation Law has raised interesting and challenging issues under cross-border insolvency law. However, a careful analysis by creditors of their rights can bring more clarity and certainty to their position and the value of their claims.

JAL’s corporate reorganisation proceedings have resulted in the use of the Model Law as implemented under Ch 15 of the US Bankruptcy Code, the UK XB Law, the Australian XB Law and the Canadian Companies’ Creditors Arrangement Act, RSC 1985, c C-36, to recognise JAL’s reorganisation proceedings as foreign main proceedings in the United States, the United Kingdom, Australia and Canada. It is possible that further recognitions in other countries which have implemented the Model Law may well become necessary in order to facilitate the implementation of JAL’s reorganisation plan. A comprehensive and compelling reorganisation plan has been approved for JAL, which appears to give JAL a second chance.

The JAL case has already provided and may continue to provide an interesting case study and test from which the insolvency community can learn more about how the Japanese Reorganisation Law and the Japanese XB Law, and indeed other implementations of the Model Law such as the Australian XB Law and the UK XB Law, work in practice.