Japan's Evolving Approach Towards the Resolution of Conflicts Arising from the Intersection of International Arbitration and Cross-Border Bankruptcy†

Hiroyuki Tezuka*

The effect of the UNCITRAL Model Law on Cross-Border Insolvency on new Japanese laws on international bankruptcy

The newly enacted Civil Rehabilitation Law and the Law on Recognition and Assistance on Foreign Insolvency Procedures

Traditionally, Japan's bankruptcy laws only applied to domestic Japanese assets, and generally followed a policy of strict territorialism. As such, the laws contained no provisions that recognised the validity or control of any foreign bankruptcy proceedings over domestic Japanese assets held by a foreign debtor in bankruptcy.

Internationally, a general trend towards the recognition of extraterritorial effects of insolvency proceedings, in the spirit of moderate universalism and harmonisation, began to gain more and more traction in the 1980s and 1990s. The United Kingdom, Switzerland, Austria and Germany

† This article is an edited version of the paper given by Hiroyuki Tezuka at the IBA Annual Conference in Vancouver in October 2010.

* Hiroyuki Tezuka is a partner of Nishimura & Asahi and heads its international dispute resolution group. He was Secretary to the Arbitration Committee of the IBA from 2005 to 2006, and Vice-Chair of the committee from 2007 to 2008.

implemented new provisions related to international bankruptcy by the mid-1990s. Additionally, in 1997, UNCITRAL adopted its Model Law on Cross-Border Insolvency (the 'Model Law'), and in 2000, the EU also adopted new regulations on international insolvency.

Recognising the international trend towards a multijurisdictional approach to bankruptcy, as well as the increase in cross-border insolvency cases, Japan's Legislative Council of the Ministry of Justice, Bankruptcy Law Committee, started to consider legislative reform on bankruptcy in October 1996, and prepared a list of issues in December 1997 for public comments.

Owing to Japan's economic situation at that time, the legislators needed to give priority to the introduction of a new type of rehabilitation proceedings aimed mainly at small and medium-sized businesses. Maintaining the obsolete policy of strict territorialism was obviously not a good idea, but logistically it was impossible for the legislators to thoroughly overhaul the international bankruptcy rules applicable to all types of bankruptcy proceedings at one time.

Thus, it was decided to introduce provisions, based as much as possible on universalism, into the newly established Civil Rehabilitation Law. Those provisions are in line with the Model Law (eg extraterritorial effect of rehabilitation procedures,[1] the introduction of mechanisms for coordination between parallel proceedings[2]) and include some improvements that are beyond the level of universalism adopted by the Model Law, such as the cross-filing system.[3]

1 The newly established Civil Rehabilitation Law applies not only to domestic Japanese assets, but also to overseas assets of the debtor.

2 Article 28 of the Model Law states: 'After recognition of a foreign main proceeding, a proceeding under [identify laws of the enacting State relating to insolvency] may be commenced only if the debtor has assets in this State.' The newly established Civil Rehabilitation Law also adopts mechanisms for coordination between parallel proceedings as a general rule, provided that under the Civil Rehabilitation Law, domestic non-main proceedings may be stayed under certain conditions.

3 As mentioned in regard to the cross-filing system, Civil Rehabilitation Act, Article 210 (Mutual Participation in Proceedings) provides as follows:

(1) A foreign trustee, while representing a rehabilitation creditor who has not filed a proof of claim but has participated in foreign insolvency proceedings against the rehabilitation debtor, may participate in rehabilitation proceedings against the rehabilitation debtor; provided, however, that this shall only apply where the foreign trustee has the power to do so pursuant to the laws and regulations of the foreign state concerned.

(2) The rehabilitation debtor, etc, while representing a holder of a filed rehabilitation claim (including one who holds a rehabilitation claim stated in a statement of approval or disapproval pursuant to the provision of Article 101(3); the same shall apply in the following paragraph) who has not participated in foreign insolvency proceedings, may participate in said foreign insolvency proceedings.

(3) The rehabilitation debtor, etc, when he/she has participated in foreign insolvency proceedings under the provision of the preceding paragraph, may perform any and all acts involved in the foreign insolvency proceedings in the interest of the holder of the filed rehabilitation claim whom he/she represents; provided, however, that delegation of powers from said holder of filed rehabilitation claim shall be required in order to withdraw a proof of claim filed, seek a settlement, or perform any other act that is likely to prejudice the rights of other holders of filed rehabilitation claims.

In 2000, those provisions were further introduced into other insolvency statutes, such as in relation to bankruptcy and corporate reorganisations, and further clarifications on international bankruptcy, such as on jurisdictional issues, were concurrently made in regard to those insolvency statutes.

Japan also introduced the Law on Recognition and Assistance for Foreign Insolvency Procedures ('RAFI') in 2000 to recognise foreign insolvency proceedings by a Japanese court's decision.

Similarities between RAFI and the Model Law

RAFI was drafted under the strong influence of the Model Law and shared its basic spirit, that is moderate universalism. As such, RAFI and the Model Law are similar on a number of points. For example, the basic scheme is similar in that a foreign insolvency proceeding is recognised through the decision of a domestic court, rather than through the automatic recognition of foreign insolvency proceedings on the fulfilment of certain conditions.[4] Additionally, both foreign main proceedings and foreign non-main proceedings may be recognised.[5] Additionally, a court can issue a provisional order for protection[6] even prior to the recognition or commencement of a foreign insolvency proceeding.

Differences between RAFI and the Model Law

One of the most important differences between the two laws is that unlike the Model Law, under which certain effects (eg a stay of legal and execution proceedings) automatically arise when a foreign main proceeding is

4 RAFI Article 22 (Order of Recognition of Foreign Insolvency Proceedings):
'(1) Where a petition for recognition of foreign insolvency proceedings that meets the requirements prescribed in Article 17, paragraph (1) is filed and a decision to commence such proceedings is made, the court shall issue an order of recognition of foreign insolvency proceedings, except where it dismisses the petition with prejudice on the merits pursuant to the provisions of the preceding Article, Article 57, paragraph (1) or Article 62, paragraph (1).'

5 RAFI Article 22 establishes procedures with regard to foreign insolvency proceedings and then distinguishes between foreign main proceedings and foreign non-main proceedings.

6 RAFI Article 51 (Provisional Administration Order):
'(1) Where a petition for recognition of foreign insolvency proceedings is filed, the court may, on the petition of an interested person or by its own authority, render a disposition to order that the debtor's business and property in Japan be administered by a provisional administrator until an order is issued on the petition for recognition of foreign insolvency proceedings, when the court finds it particularly necessary in order to achieve the purpose of the recognition and assistance proceedings.'

recognised,[7] RAFI always requires the discretionary decision of a court to give rise to any particular effect. This is not because it was intended to provide narrower protection than the Model Law; the rationale is that by requiring a court decision on any requested relief, the courts will be more comfortable in issuing orders to recognise foreign insolvency proceedings.

Another important difference is that on the face of it, RAFI[8] only refers to the stay of 'procedures for compulsory execution, provisional attachment, or provisional disposition', 'court proceedings', and procedures pending in a government agency (ie 'administrative proceedings'), compared with the broader language of the Model Law, Article 20.1 (which refers to 'individual actions or proceedings').

The staying of arbitration proceedings

Arguments pertaining to wording differences

The difference between the wording of the subject of the stay used by RAFI and the Model Law as mentioned above has caused debate as to the exact scope of the proceedings that can be stayed under the RAFI. Specifically, there are arguments as to whether an arbitration proceeding can be stayed under RAFI, as the language of the RAFI, which is more specific than that of the Model Law, may appear to read that arbitration procedures are not included in any of the proceedings specifically mentioned therein. Practically, however, in many situations, obtaining a stay order from a

7 The Model Law, Article 20 (Effects of recognition of a foreign main proceeding):
'1. Upon recognition of a foreign proceeding that is a foreign main proceeding:
(a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations, or liabilities is stayed;
(b) Execution against the debtor's assets is stayed;
(c) The right to transfer, encumber, or otherwise dispose of any assets of the debtor is suspended.'

8 RAFI Article 25 (Stay Order, etc on Other Procedures and Proceedings):
'(1) The court may, when it finds it necessary in order to achieve the purpose of the recognition and assistance proceedings, on the petition of an interested person or by its own authority, order a stay on the following procedures or proceedings, on issuing an order of recognition of foreign insolvency proceedings or after issuing such order:
(i) Procedures for compulsory execution, provisional seizure, or provisional disposition (hereinafter referred to as 'compulsory execution, etc'), which have already been initiated against the debtor's property (limited to property which exists in Japan; hereinafter the same shall apply in this paragraph);
(ii) Court proceedings in an action relating to the debtor's property; and
(iii) Procedures in a case relating to the debtor's property that are pending before an administrative agency.'

Japanese court is not the only possible relief to effectively stay an arbitration conducted in Japan or involving a Japanese party. For example, if the seat of arbitration is outside Japan, or the law governing the arbitral proceeding is non-Japanese law, a foreign debtor or its bankruptcy trustee may apply for a stay of arbitration in accordance with the law of the seat of arbitration or the governing law of the arbitral proceeding. Even where the seat of arbitration is Japan (in which case, under the Japanese Arbitration Law, the same law shall apply to the arbitral proceeding), and where a Japanese court refuses to stay the arbitration on the ground that RAFI does not allow it to do so, the foreign court presiding over the foreign insolvency proceeding may order a stay of the arbitration to the extent that it has personal jurisdiction over the other party to the arbitration.

This same issue that relates to the drafting of the subject of the stay under RAFI, that is the ambiguity as to whether a court can stay arbitration, as opposed to execution, litigation or administrative proceedings, also arises in the context of a wholly domestic bankruptcy, as Japan's bankruptcy laws use the same or similar wording in respect of the subject of a stay.[9] There is consensus, however, that when an insolvency proceeding commences: (i) any execution proceeding in courts based on an arbitral award shall be stayed; and (ii) any court proceeding for granting an execution based on an arbitral award shall

9 The Bankruptcy Act, Article 24 (Stay Order, etc for Other Procedures and Proceedings): '(1) Where a petition for commencement of bankruptcy proceedings is filed, the court, when it finds it necessary, on the petition of an interested person or by its own authority, may order a stay of the following procedures or proceedings until an order is made on the petition for commencement of bankruptcy proceedings; provided, however, that this shall only apply, in the case of the procedure set forth in item (i), if the stay order is not likely to cause undue damage to the creditor who filed the petition for the procedure, and in the case of the proceedings for limitation of ship-owners' liability set forth in item (v), if an order of commencement of proceedings for limitation of ship-owners' liability has not yet been made:

(i) Procedures already initiated against the debtor's property for compulsory execution, provisional seizure, provisional disposition, or exercise of a general statutory lien or auction by reason of a right of retention (excluding a right of retention under the provisions of the Commercial Code (Act No 48 of 1899) or the Companies Act) (hereinafter referred to as 'compulsory execution, etc' in this Section), which are based on a claim that is supposed to be a bankruptcy claim or claim on the estate should an order of commencement of bankruptcy proceedings be made against the debtor (hereinafter referred to as a 'bankruptcy claim, etc' in this paragraph and paragraph (8) of the following Article), or are intended to secure a bankruptcy claim, etc.

(ii) Procedures already initiated against the debtor's property for the exercise of an enterprise mortgage, which are based on a bankruptcy claim, etc.

(iii) Court proceedings of an action relating to the debtor's property.

(iv) Procedures for a case relating to the debtor's property that is pending before an administrative agency.'

also be stayed. It is also generally accepted that if a bankruptcy creditor fails to file a proof of claim with the bankruptcy court, he/she will not be able to participate in the distribution from the bankruptcy estate even if he/she obtains an arbitral award against the bankruptcy debtor. Therefore, in practice, a bankruptcy creditor who is a party to an arbitration against the bankruptcy debtor would normally elect to file a proof of claim rather than simply disregard the insolvency proceeding, and it is often in the best interests of both the creditor and the debtor to await the results of the investigation of the claim in the insolvency proceeding rather than spend time and money on arbitration.

Determinations of disputed claims that are subject to arbitration agreement

Once a claim, in respect of which a proof of claim was filed, is objected to by the trustee or the debtor in possession, a legal issue arises as to whether the dispute over the claim shall be resolved in arbitration or in the bankruptcy court. The views of commentators in Japan are divided, and it appears that there is no published Japanese court precedent on this issue. Some argue that the trustee or the debtor in possession may select whether or not to accept an arbitration agreement, either on the ground that an arbitration agreement itself is an executory contract or on other grounds. Others argue that non-core issues, or issues arising from the status of the debtor, which the debtor could have solely disputed prior to the commencement, shall be resolved by arbitration; and core issues, or issues arising from the status of all bankruptcy creditors, such as voidance, preference, perfection and limitations on setting-off, shall be inherently resolved by the bankruptcy court rather than an arbitral tribunal.

As noted above, the international trend seems to be towards increased universalism, whereby proceedings in other countries can be stayed by courts where the main bankruptcy proceedings are in progress, particularly with regard to what can be considered to be 'core' issues of the bankruptcy. This approach bears advantages in predictability, fairness and avoidance of duplication of efforts. Otherwise, disparate arbitration proceedings in different countries, with different claimants and underlying claims, might be decided differently, leading to different and unfair results for different claimants. The global trend is towards a modified universalism, under which temporary stays of arbitration may be granted in each country where arbitration proceedings are brought on the institution of insolvency proceedings in the 'main' country of the bankruptcy.

Court and arbitration precedent

It is interesting to note that in cases where a Japanese debtor has filed a petition for insolvency proceedings and thus requests a stay on arbitration outside Japan, Japanese courts have given permission for the debtor, or the provisional trustee, to apply for such a stay in the relevant foreign jurisdictions.

Taisei Fire & Marine Insurance

In the corporate reorganisation of Taisei Fire & Marine Insurance, filed in 2001, the provisional trustee obtained a preliminary injunction to stay all proceedings (including arbitration) in the US under Section 304 of the Bankruptcy Code (which was later converted into a permanent injunction whereby the US Bankruptcy Court recognised and enforced a Japanese court's order to approve the reorganisation plan, the result of which was that the creditors were prohibited from exercising their rights on the reorganisation claims except as permitted under the plan) and also moved for appointment of joint provisional liquidators in the UK, both based on an approval by the Japanese bankruptcy court for the provisional trustee to apply for such reliefs.

Japan Airlines

When Japan Airlines filed a petition for corporate reorganisation in 2010, it also applied for protection under Chapter 15 of the US law, thereby effectively preventing the filing or continuation of: (i) any litigation or arbitration in the US by anyone; and (ii) any litigation or arbitration elsewhere by any person or entity that was subject to the personal jurisdiction of the US Bankruptcy Court.

ICC Case No 12993

In contrast to the above cases was ICC Case No 12993 (January, 2003), which was brought in Japan, and was between a Singaporean company as claimant and a Korean company and its affiliates as respondents, where the Korean affiliate went into receivership in Korea after the arbitration began. The tribunal found that Korean bankruptcy law did not 'purport to apply to litigation or arbitration occurring outside of Korea'. In this case, the tribunal seems to have applied the principle of territoriality, rather than universality, in deciding whether or not to apply foreign national insolvency laws to arbitration proceedings in Japan.

This may stem from the fact that Japanese arbitration law (both the pre-2004 old law and the new Arbitration Law, which came into effect in

2004) itself is silent as to whether and to what extent the arbitral tribunal is bound or affected by foreign insolvency proceedings. If the Korean party had selected to seek a relief under RAFI and if the case had come before a Japanese court, the court would have considered two issues: (i) whether RAFI could stay arbitration proceedings; and (ii) whether it is obvious or not that the effect of the Korean bankruptcy proceedings does not extend to the debtor's property in Japan.[10]

Conclusion

These precedents indicate that Japanese courts have recognised the need to stay arbitrations outside Japan for the purpose of administering insolvency cases in Japan in an orderly manner. Indeed, there have been cases where the stay of arbitrations outside Japan was crucial to successful reorganisation of failed Japanese debtors who would have otherwise needed to conduct numerous arbitration proceedings outside Japan. While there is uncertainty as to whether Japanese courts may stay arbitration procedures in Japan to protect the debtor in foreign bankruptcy proceeding, there appears to be no case where such stay was indeed necessary for orderly administration of foreign insolvency proceedings, but the Japanese courts nevertheless denied such relief simply based on the wording of RAFI in regard to the subject of such stay. There is also uncertainty as to whether the final determination of a claim, which was the subject matter of an arbitration in or outside Japan, but in respect of which a proof of claim was filed in a Japanese bankruptcy proceeding, and to which the bankruptcy trustee objected, shall be made in arbitration or in court. However, practically, the creditor may find it too costly and time-consuming to proceed with the arbitration, particularly where the bankruptcy estate is not large enough to warrant such time and cost. Thus, while we note the general global trend towards modified universalism, which is now shared by Japanese legislation and Japanese courts, Japanese courts and Japanese bankruptcy practitioners have often acted in a pragmatic manner to satisfy the practical needs without having to resolve some of the ambiguity existing under the bankruptcy laws.

10 RAFI Article 21 (Conditions for Recognition of Foreign Insolvency Proceedings): 'If any of the following items applies, the court shall dismiss with prejudice on the merits a petition for recognition of foreign insolvency proceedings:
(ii) where it is obvious that the effect of the foreign insolvency proceedings does not extend to the debtor's property in Japan.'