

Under the Law on Special Measures for Industrial Revitalization and Innovation
Turnaround ADR (Alternative Dispute Resolution)
- For the early revitalization of business and industry

January 2010
Industrial Revitalization Division
Ministry of Economy, Trade and Industry

What is Turnaround ADR (Alternative Dispute Resolution) ?

Turnaround ADR has been created for the rehabilitation of companies suffering from financial difficulties .

This proceeding helps coordination between the financial creditors and debtors, under independent specialist s, and reduction of the tax burden for both debtors and creditors when the creditors agree to debt forgiveness and facilitates bridge loans (Dip Finance).

What is Turnaround ADR ?

-ADR: Alternative Dispute Resolution

This is a proceeding under which an independent third party is engaged on behalf of the relevant parties to assist them in resolving a civil dispute without litigation.

-Turnaround ADR

The Turnaround ADR proceedings was created by an amendment of the Law on Special Measures for Industrial Revitalization and Innovation in fiscal year 2007.

The purpose is to facilitate the business rehabilitations of companies in financial difficulties.

-Caution

We have prepared this translation of a summary of the Turnaround ADR for your convenience. For more detailed information, see the Japanese Law on Special Measures for Industrial Revitalization and Innovation.

Advantages of Turnaround ADR (Alternative Dispute Resolution)

Advantages of the ADR for restructuring companies

	Concept	Means
Allows companies to continue operating smoothly	- Basically, this proceeding is an accommodation between debtor companies and financial creditors and doesn't require the involvement of trading creditors.	-
Credibility	- This proceeding is controlled by mediators, who are professionals specializing in company/business turnarounds.	- The dispute resolution providers are approved and authorized by the Ministry of Economy, Trade and Industry, which selects suitable specialists with the requisite knowledge of business revitalization, as defined by the Ministerial Ordinance concerning Alternative Dispute Resolution on Business Rehabilitation (METI 2007).
Facilitates bridge loans	- Guarantees for the debtor can be obtained from the Organization for Small & Medium Enterprises and Regional Innovation, Japan (SMRJ). - Preference in payment at the time of transfer from the Turnaround ADR to a legal insolvency proceeding.	- Debt guarantees are provided by the Organization for Small & Medium Enterprises and Regional Innovation (for medium and large enterprises) - Special rules by the Small Business Credit Insurance Act (for small and medium enterprises)
ADR proceedings and outcomes to be respected by Courts.	- In case of transfer to Specified Conciliation proceedings, the step of Turnaround ADR is considered to fall under the legal insolvency proceedings.	- Arbitration by a one-person judge instead of three members of a committee is simple and rapid.
Gains made by cancellation debts are tax-exempt in principle	-	- Asset evaluation standard - Tax advantages

Legal insolvency proceedings

Advantages

- Credibility
- Fair proceedings under supervision by the court
- Gains made by debt forgiveness are tax-exempt in principle.
- Appraisal of profit or loss

Disadvantages

- Lose trade consumers
- Disclosure of proceedings may harm reputation
- Deteriorates the value of the business

Integrate advantages

Out-of-court resolution

Advantages

- Allows business to carry on smoothly
- Allows companies to carry on business and talk to creditors and financial institutions even while under the proceedings

Disadvantages

- Gain from debt forgiveness is subject to taxation.
- Difficulty to get unanimous consent at creditors' meeting

Certified ADR and Turnaround ADR

Certified ADR (Act on Promotion of Use of Alternative Dispute Resolution)

Certified ADR are proceedings for the resolution of civil disputes between parties who seek, with the involvement of a independent third party, a resolution without using litigation. Business ADRs are specialized ADRs for business turnaround.

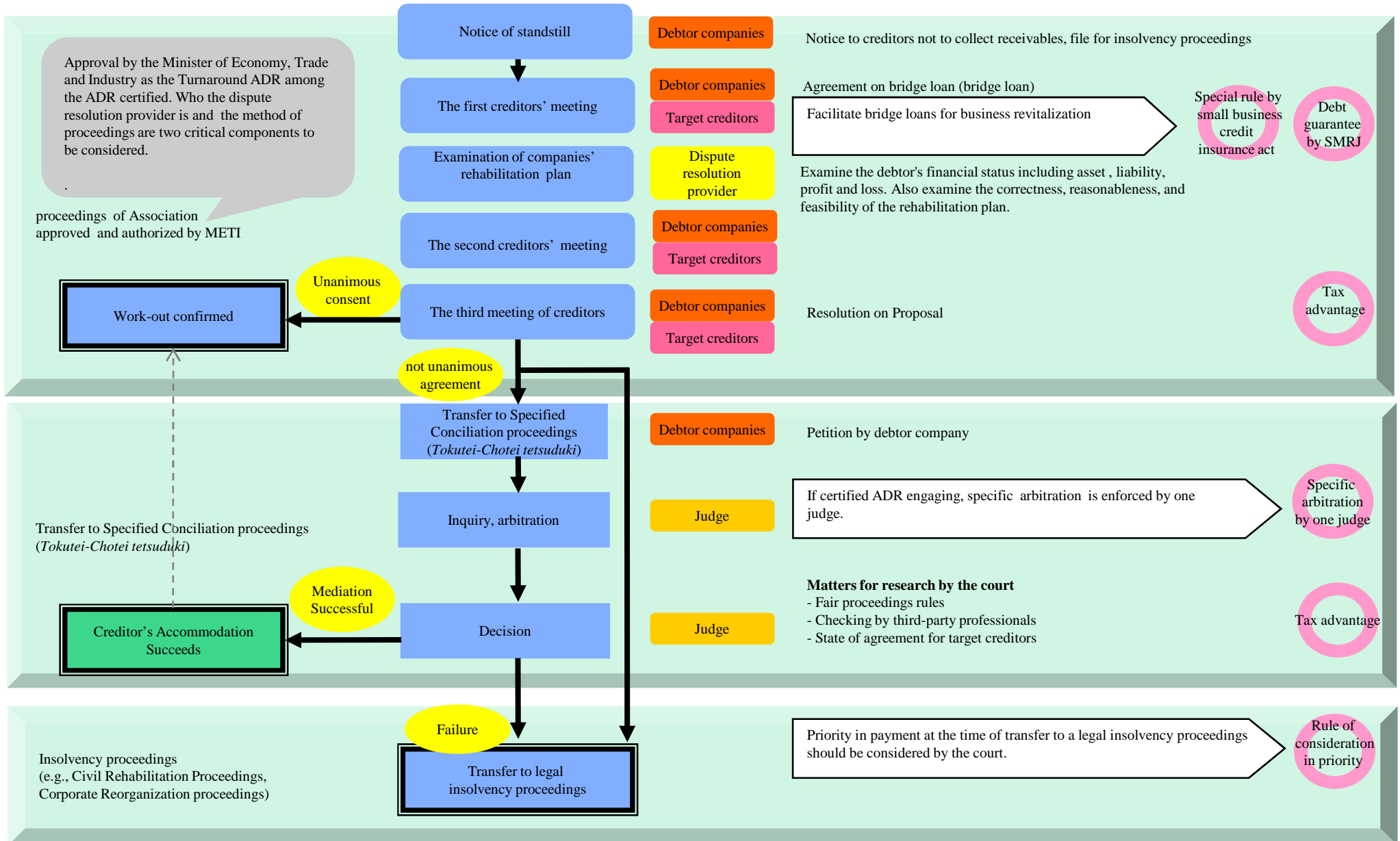
(Government confirms and authorizes procedural fairness for businesses, and provides knowledge, skill and experience.)

Civil ADR, Certified ADR and Turnaround ADR		Division	Law and ACT	Requirements as ADR Association	Effects
<p>The flowchart illustrates the relationship between different types of ADR. It starts with 'Civil ADR' in a yellow oval at the top. A green arrow points down to 'Certified ADR' in a light green oval. A red arrow labeled 'Certification' points from 'MOJ' (Ministry of Justice) to 'Certified ADR'. From 'Certified ADR', another green arrow points down to 'Business Revitalization ADR' in a blue oval. A red arrow labeled 'Authorization' points from 'METI' (Ministry of Economy, Trade and Industry) to 'Business Revitalization ADR'.</p>	Certified ADR	Act on Promotion of Use of Alternative Dispute Resolution (MOJ)	<ul style="list-style-type: none"> · Meet certification Standards under Article 6 from clause 1 to clause 16. · Possess necessary knowledge and skills as well as accounting foundation for carrying out ADR services (Article 6). · Not applicable for disqualification clause (Article 7). 	<ul style="list-style-type: none"> · Exclusive right to represent itself as a licensed business. · Can collect fees to engage in mediation activities to achieve a settlement. · The statute of limitations will be advised on request. · Provision is made to suspend litigation proceedings. · The requirement to seek prior mediation proceedings can be waived. 	
	Turn-around ADR	Law on Special Measures for Industrial Revitalization and innovation (METI)	<ul style="list-style-type: none"> · To be able to select persons as Mediators who have the necessary knowledge concerning business revitalization and experience, as defined by the Ministerial Ordinance Concerning Alternative Dispute Resolution on Business Rehabilitation (METI 2008). · To have proceedings of Alternative Dispute Resolution in business ,which is defined by Article 48. 	<p>Same effects as Certified ADR:</p> <ul style="list-style-type: none"> · Exclusive right to represent itself as a Turnaround ADR. · Same as above 2 through 4 of certified ADR <p>Additional effects:</p> <ul style="list-style-type: none"> · In case of transfer to Specified Conciliation proceedings (<i>Tokutei-Chotei tetsuduki</i>), proceedings engaged in by only one judge are simpler than the general process. Engaged by only judge. <p>Facilitates bridge loans as follows:</p> <ul style="list-style-type: none"> ✓ Guarantees for the debtor can be obtained from the Organization for Small & Medium Enterprises and Regional Innovation, Japan (SMRJ). ✓ Priority in payment at the time of transfer from the Turnaround ADR to a legal insolvency proceeding. 	

Note: MOJ=Ministry of Justice, METI=Ministry of Economy, Trade and Industry

Flow of Turnaround ADR proceedings

Using the framework of work-out, which protects the reduction of the value of the company through cooperation among creditors, in addition to the unique feature of simple and early revitalization method on an anonymous basis.



Overview of the assistance measures

Bridge loans

1. Preference in payment at the time of transfer to a legal insolvency proceeding.

If Turnaround ADR proceedings fail and translate to legal insolvency proceedings, bridge loans, which are necessary for ADR proceedings from start to end, have preference in payment. If these bridge loans are confirmed for rationality and the agreement of all creditors, the judge should take priority in payment into consideration.

2. Debt guarantee by the Organization for Small & Medium Enterprises and Regional Innovation (medium and large enterprises)

If bridge loans are necessary for business continuance during ADR proceedings, the Organization for Small & Medium Enterprises and Regional Innovation guarantee the finance.

3. Special rule by Small Business Credit Insurance Act (for small and medium enterprises)

This system is for small and medium enterprises. Debtor companies use additional guarantees other than the usual proceedings.

Arbitration by one-person judge

The Specified Conciliation proceedings (*Tokutei-Chotei tetsuduki*) are procedures for problem resolution supervised by an arbitration committee at the court.

The committee can stipulate provisions including equity, reasonableness, and rationality to facilitate the financial revival of debtors.

In general, the committee consists of a judge and two professionals with relevant knowledge including on legal, tax, finance, corporate finance, and asset valuation areas.

(Act for Conciliation of Civil Affairs, Article 6). Under Turnaround ADR, the Specified Conciliation proceedings are engaged in by only one judge. The judge takes consideration of the results of former business revitalization proceedings. Therefore, the company recovers from the crisis and succeeds in speedy business revitalization.

Tax advantages

Gains from the debt forgiveness by the debtor and realization of gains or losses from the debtor's assets:

1. The appraised profit and loss which is estimated by evaluation under the Turnaround ADR can be included in gross revenue and expense with respect to computing taxable income.

(Article 25, paragraph 3 of Corporate Tax Law)

2. When the above is being applied, expired deficits can be used before the normal deficits for the last seven years when the debtor can set off the profit by the debt forgiveness. (Article 59, paragraph 2, Item 2 of Corporate Tax Law)

Losses come from debt forgiveness of debtor:

In general, debt forgiveness done by creditors under the rehabilitation plans are treated as taxable loss because the plan made under the specific certified dispute resolution proceedings are considered to be reasonable rehabilitation plans (corporation tax basis notice 9-4-2).

What is a standstill?

Turnaround ADR proceedings start from a standstill notice to target creditors after debtor companies' application

What is a standstill?

A standstill includes notices about reception, which are pleadings prohibiting target creditors from acting for the following: set-off; requirement of physical and personal collateral; compulsory, provisional garnishment; provisional disposition; petition for legal insolvency proceedings (the ministerial ordinance concerning Alternative Dispute Resolution on business rehabilitation (METI 2008), Article 7).

Overview of standstill

Contents

Nature	Standstills are not compulsory. If creditors don't agree to them, creditors are not penalized. Creditors refrain from collecting receivables and taking others actions for a certain period of time by agreement of all the creditors at the first creditors' meeting. Therefore, a standstill isn't generally deemed to be default.
Scope of target claims	Basically, this proceeding is an accommodation between debtor companies and financial creditors and doesn't require the involvement of trading creditors. In some cases, financial creditors whose exposure is minimal are not called to participate in the proceedings. On the other hand, big trade creditors are called to participate in the proceedings.
Process after the notice of standstill.	The first creditors' meeting is held within two weeks from the day of the standstill notice (Article 7). At this meeting, an explanation of debtor companies' assets and liabilities as well as a summary of the rehabilitation plan made by the debtor is given, followed by events such as a question-and-answer session and an exchange of opinion session (Article 9). Also, the creditors confirm an interaction continuing ADR proceedings (Article 2, Section 1).

Advantages for debtor companies

- Allows the debtor breathing time to make a rehabilitation plan as well as coordination between creditors under the proceedings.
- Facilitates bridge loan from financial institution for business revitalization.

Advantages for target creditors

- Expect to collect higher amount of receivables than the amount under the legal insolvency proceedings.

That is to say, when creditors do collect receivables in spite of the notice of standstill, there will be a high possibility for the debtor to file under legal insolvency proceedings, taking over the ADR proceedings. In this case, the distribution for creditors may be less than under the ADR because the value of the debtor's business must be decreased under the delayed proceedings. As a result, the amount of distribution for creditors must be decreased for all the creditors compared to distribution under the ADR proceedings.