

**The Governance of Failure:
An Anatomy of Corporate Bankruptcy in Japan**

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1. INTRODUCTION

The law of corporate bankruptcy in the United States has recently been subject to the most intense wave of criticism since the Bankruptcy Reform Act of 1978. In particular, the various provisions of Chapter 11 which not only favor management's continued control of the corporation, but also grant it numerous means to escape or delay the execution of prior commitments with creditors, have come under attack.¹ In the view of its critics, Chapter 11 has facilitated abusive filings, either to avoid the claims of particular classes of creditors,² or more generally to extract rents from all creditors in the form of deviations from absolute priority, blurring important *ex ante* distinctions at a cost to social welfare.³

Accompanying the criticism have been proposals for reform. A wide variety of these aim to check opportunistic abuse of the protection of bankruptcy law by debtors and their management through revisions of the law.⁴ The most extreme of the proposals calls for the abolishment of court-supervised corporate reorganizations altogether: the so-called "perfect markets solution."⁵ Ironically, much of the recent scholarship on bankruptcy has formalized the benefits to bankruptcy law and

provided efficiency rationales for numerous of the individual provisions.⁶ Balancing these benefits with the costs of potential opportunistic abuse has long been a major problem of bankruptcy policy.⁷

The broad trade-offs facing bankruptcy policy are, of course, not uniquely American. In this paper, we survey the Japanese corporate bankruptcy system, and present a comprehensive empirical analysis as to how it works in practice. Our framework for analysis is a variation on a theme of transaction cost economics: instruments of bankruptcy policy should effect a discriminating alignment between firms and the institutions governing failure, one which grants the services of legally centralized recontracting to those cases that warrant it, while maintaining incentive-intensity in private ordering for the others. (Williamson, 1985;1989) This paper, through the examination of bankruptcy statistics, and the analysis of bankruptcy laws, courts and other institutions governing business failure in Japan, presents the Japanese system as a case study of corporate bankruptcy policy and institutional design.

One Japanese approach to the alignment problem in bankruptcy has been the provision of many distinct bankruptcy laws which provide differing combinations of legal centralism versus private ordering. In both liquidation and reorganization, Japan offers an array of strong proceedings, whereby the court is given powers to step in to settle a wide spectrum of financial recontracting problems, in combination with an array of "weak" proceedings, whereby the court's powers are far more limited and designed to serve more as a "hands-off" supplement to private settlement. A related approach to the alignment problem has been the extensive use of a variety of gatekeeping mechanisms through which courts screen the candidates and limit abuse of bankruptcy law protection. We will present evidence that characteristics of firms which enter the various bankruptcy proceedings do indeed correspond in predictable fashion to the governance mechanisms and gatekeeping features of the proceedings.

Another aspect of alignment is between failures which end up in bankruptcy court, and failures which are settled out of bankruptcy court. Bankruptcy court use is limited to a small fraction

of all corporate bankruptcies in Japan in large part because of gatekeeping features which apply to all or most of the proceedings. For instance, an advance payment of costs requirement not only keeps out those bankruptcies of negligible assets, but encumbers reorganization applications as well. The discretionary, not automatic, granting of stay, and certain courts' interpretation of their discretionary powers, further limits reorganization court petitions. Applications to the most powerful reorganization court in Japan - itself based on now-defunct U.S. reorganization law - are further limited by the fact that the law forces the management to relinquish their power upon entry into the procedure. Nonetheless, we will also present evidence that differences in the characteristics of firms that end up in bankruptcy court from those that don't correspond to a discriminating alignment which would be predicted based on efficiency concerns.

Strict court gatekeeping which turns away most potential applicants carries with it the same sort of potential costs as a repeal of bankruptcy protection altogether: near-default costs caused by non-optimal operating strategies undertaken by managers to avoid default. An aspect of the Japanese system which has lowered such costs has been the existence of private actors which increase the relative efficiency of private ordering and facilitate the resolution of business failure outside of court.

In contrast to the well-documented "main bank" rescues, business failures in Japan are dominated by cases which result in the private liquidation of the bankrupt, and those cases which are privately organized are generally managed by trade creditors of the bankrupt, operating to a large degree within "the shadow of the law." (Mnooking and Kornhauser, 1979, Ellickson, 1991)

Nonetheless, many liquidations are not well organized, and the high incurrence of near-default costs is an important characteristic of the Japanese system. The difficulty of gaining entrance into bankruptcy court, along with more general limits on court authority and efficiency in Japan appear to be related to an extensive involvement of organized crime in private liquidations, with undoubted ancillary social costs.⁸ Frequent creditor panic at the time of out-of-court bankruptcy constitute another cost. On the whole, however, the Japanese bankruptcy system appears to provide a set of

alternative governance structures which is consonant with an extended efficiency rationale.

The paper is organized as follows. In Section 2, we introduce and explain the statistical categories of bankruptcy in Japan, and in so doing chart the road map which faces the firm going bankrupt in Japan. In Section 3, we compare the principal features and application of Japan's five bankruptcy laws (although detailed explication is left to Appendix 1) and present substantial empirical evidence of a discriminating alignment of firms with the various alternatives of legal proceeding. In Section 4, we examine the three principal patterns which characterize private liquidation - the principle avenue for business failure in Japan - and present evidence of discriminating alignment of firms between the court and private modes of handling business failure. In Section 5, we conclude.

2. GETTING THERE: THE WAYS TO GO BANKRUPT

2.1 The Statistical Categories of Corporate Bankruptcy. Corporate bankruptcy statistics are commonly used in Japan as indicators of the state of the economy. Most frequently cited are the statistics presented by Tokyo Shoko Research of the business failures of enterprises which have liabilities of more than 10 million yen. Although until recently the relative amount of business failures of this magnitude did not greatly differ from comparable firm samples in the United States,⁹ the published categories into which the bankruptcies are divided have long been distinctive in a number of respects.¹⁰

Place Table 1 here

One striking feature is the multiplicity of bankruptcy court options. While the bankruptcy law of most capitalist economies specifies two sets of rules - one for liquidation and one for reorganization - in Japan, there are five types of legal corporate bankruptcy.¹¹ The first two columns of Table 1 represent applications for the two bankruptcy court proceedings primarily intended for

liquidation in Japan, Bankruptcy (Hasan) and Special Liquidation (Tokubetsu Seisan), respectively, while the next three, Corporate Reorganization (Kaisha Kosei), Corporate Arrangement (Kaisha Seiri), and Composition (Wagi) reflect applications for those bankruptcy courts intended for reorganization.¹²

Another characteristic of the bankruptcy data in Table 1 is the existence of two categories of business failure in Japan which do not fall under bankruptcy in the legal sense.¹³ First, there is a category "Internal Arrangement" (Uchi Seiri) which contains those firms for which a formal creditors' meeting was held, and there was an agreement among all which aim at the continuation of the company, which included the suspension of debts. However, according to Tokyo Shoko, this category is mostly small and medium sized firms, and not inclusive of most private workouts of the debt of large financially distressed firms in Japan. In particular, it does not include the most well-known bailouts of large firms by their main bank which constitute the mainstay of the main bank literature. Thus, most large main bank bailouts do not fall into any of these categories, and are not recorded as business failures.¹⁴

Secondly, there is the category entitled the "Suspension of Bank Transactions," which consistently has constituted the overwhelming majority - more than 90% - of all the business failures reported by Tokyo Shoko Research. Firms enter this category if there is notice at the local clearinghouse of their promissory note being dishonored two times within a six month period. This triggers a sanction procedure executed by member banks which suspend all current account transactions and loans with the firm for a period of two years.¹⁵

There is widespread agreement in Japan that the sanction of the suspension of bank transactions is the corporate equivalent of capital punishment, in that it inevitably results in the shutting down of the business.¹⁶ For this reason, the avoidance of the fatality of two dishonored bills is the first concern of all Japanese companies in financial distress. Seeing bills due in the near future that cannot be covered by projected cash holdings, a firm must arrange for the delay of some or all

of its bill obligations, or find a sponsor such as a main bank willing to shoulder the obligations for them in order to survive.¹⁷

2.2 The Process for Entering or Avoiding Bankruptcy Revisited. What do these categories imply about the process of going bankrupt in Japan? The answer is not entirely clear from the few articles in English which describe bankruptcy in Japan. One important article has implied that the suspension is equivalent to the general term for bankruptcy (tosan), and the choice by the firm and its creditors between the various legal and informal procedures is made **subsequent** to the suspension. The argument is further made that reorganization of problem loans managed by a main bank is one of those informal procedures that would follow the suspension. (Corbett, 1987: 49-50)

However, this view of the suspension procedure is not consistent with the above description of it as a foreseeable and undesirable contingency. Because the impact of suspension is so unmistakable, and can trigger an immediate rush on the firm's assets, failing businesses which apply to bankruptcy court to obtain protective services such as a stay will do so **prior** to dishonoring of a second promissory note. (Takagi: 1988, 2-3) Similarly, firms which hope to overcome their financial crisis, and can work out a rescheduling of their debts with the cooperation of their creditors will do so prior to the dishonoring of the second note. Thus, with rare exception, bankruptcy court applications, main bank bailouts, and internal arrangements leading to reorganization all lie outside the universe of firms which have received the suspension of bank transactions.¹⁸

Place Figure 1 here

A chart which places the statistical bankruptcy categories within the context of the bankruptcy process is given in Figure 1.¹⁹ In a broad sense, there are two distinctions to be made between the different paths. One distinction is between those paths which end near the top of decision tree and

result in the continuation of the firm as a going concern and those below which result in the firm's liquidation.²⁰ The other is between those paths which enlist the assistance of a bankruptcy court, and those that do not. As discussed above, firms which receive the suspension of bank transactions neither continue as going concerns, nor have they enlisted the assistance of bankruptcy court. In this sense, they can be thought of as private liquidations.

2.3 Firm Size Distribution and Bankruptcy Categories.

The relative dominance of these private liquidations, and the resulting fact that relatively few bankruptcy cases go to court in Japan evident in Table 1 could be an artifact of the size of the firms. In Table 2, we examine the distribution of those same bankruptcy cases for the years 1985-1990 broken down by paid-in capital and liabilities. Nearly half of the cases were below 50 million yen (\$375,000)²¹ in liabilities, while more than three-quarters of the firms were either unincorporated or capitalized at less than 10 million yen (\$75,000).

Place Table 2 here

The small size of these firms suggest some reasons why many do not involve bankruptcy court proceedings. First, a small liability amount should make liquidation easier to work out privately: ceteris paribus, creditors will be fewer in number and therefore less subject to the collective action problems which often motivate a use of bankruptcy court. Secondly, firms may simply not have enough assets to provide a rationale for costly bankruptcy court proceedings. Documentation for the second point was provided more than 10 years ago by Ito and Tanase, who in a study of 78 companies which underwent private liquidation in the Nagoya region, found that more than 55% of the cases paid no distributions to creditors. (Ito and Tanase: 228-229)

We should expect then, that as we move up the size scale of corporate bankruptcy in Japan, that the dominance of the suspension of bank transactions/private liquidation route relative to court-

based bankruptcy would diminish greatly. In Table 3, we examine the bankruptcy category breakdown of the very largest bankruptcies (less than 1%) by size of liabilities for the years 1988-1990. During this period, 185 firms went bankrupt which had liabilities of over 3 billion yen (\$22.5 million). This time the data are from Japan's other principal credit rating agency which follows corporate bankruptcies, Teikoku Data Bank.²²

Place Table 3 here

As expected, larger bankruptcies are more likely to rely on bankruptcy court. More than 40 percent of the large sample constituted an application to bankruptcy court, as opposed to around 5% of the Table 1's sample for the same time period. Nevertheless, even at this scale, business failures which end up incurring the suspension (and thus being privately liquidated) dominate the sample, consisting of more than 100 of the 185 firms. Clearly, there is more to the prominence of private liquidation in Japan than fly-by-night operations and the turnover of Mom-and-Pop sushi shops. Part 4 will examine the procedures of such private liquidation in more detail. But first we will examine the legal categories of bankruptcy in Japan.

3. THE FIVE BANKRUPTCY COURTS²³ AND THEIR GOVERNANCE FEATURES

3.1 Bankruptcy Court as a Governance Structure. Bankruptcy court, in combination with the law it is meant to enforce, represents an ex post governance structure for the resolution of those recontracting, bargaining and coordination problems attendant to business failure. In both the brief section that follows and in greater detail in Appendix 1, we will compare Japan's bankruptcy laws in terms of the following governance mechanisms:

a) Stay of Claims. Provisions for the "stay" or freeze of all hostile creditor actions against the bankrupt firm may forestall a premature and inefficient liquidation if creditors were to engage in a

costly race to be the first to sue the firm for repayment.²⁴ (Jackson, 1982,1986)

b) Distribution of the Proceeds. Similarly, clear impartial procedures for the verification and valuation of claims offered in bankruptcy court may also deter panic and incentives to resort non-collective solutions.²⁵

c) Voting Rules. The resolution of inter-creditor conflicts may be further aided by the voting rules of bankruptcy law: lowering the coordination costs incurred if any creditor had the ability to hold up a successful restructuring or liquidation, no matter how small and insignificant her claim. (Roe, 1987; Brown, 1989)

d) Management and Control/Availability of Discovery²⁶ Articles which relate to the availability of discovery, or the transfer of control of the estate or firm to a court-appointed trustee, serve to correct for the fact that in the absence of bankruptcy court, a financially distressed debtor may be more likely to misrepresent information,²⁷ and either over- or under-invest from the creditors' point of view.²⁸

e) The Treatment of Secured Claims. The degree to which security rights are allowed to be exercised apart from bankruptcy proceedings is an important aspect of many of the Japanese bankruptcy courts.

f) Avoidance. Court powers to avoid fraudulent conveyances and preferential transfers provide creditors with a means of going back in time and reversing the removal of assets by the debtor. (Baird, 1991)

g) Provisions for New Senior Financing. A feature of importance principally in reorganization, the granting of senior status of new lending to the debtor which has applied for bankruptcy is often necessary for the debtor to survive as a going concern (Baird, 1992: 211-213)

The bankruptcy policy debate concerns the capabilities of debtors and their managers to opportunistically exploit some of the above mentioned governance mechanisms (in particular the stay). One way Japan's bankruptcy system turns back candidates is by simply limiting the protection for

many of the proceedings. In particular, secured creditors are not included in most of the proceedings. Only one of the three reorganization proceedings provides for new senior financing, while another has no voting rule to override holdouts.

Access to bankruptcy court services is further limited by gatekeeping rules for entry which both discourage opportunistic abuse and effect alignment between the proceedings. Gatekeeping includes application and other procedural requirements as well as court screening. These generally differ between the proceedings depending on the potential for abuse. In addition, many important gatekeeping features are common to all of the bankruptcy proceedings - such as the requirement of an advance payment of costs, or court discretion over the timing of the stay order - which increase reliance on the private governance of bankruptcy.

3.2 The Bankruptcy Courts for Liquidation. There are two laws whose principle purpose is to govern the liquidation of bankrupt companies in Japan: Bankruptcy (Hasan) and Special Liquidation (Tokubetsu Seisan). Bankruptcy (which we shall capitalize whenever the specific law is referred to) is by far the most commonly used procedure in corporate Japan. In the Tokyo Shoko sample introduced above, firm applications for Bankruptcy outnumber those for Special Liquidation by orders of magnitude ranging from 20 to 100 times. In the small sample of large bankruptcies (Table 3), there are nearly ten times as many Bankruptcy applications.

3.2.1 Governance Mechanisms. The greater popularity is in no small part related to the far greater scope of Bankruptcy Law's governance mechanisms. (Appendix 1). First, firms where creditor panic is likely upon the announcement of business failure will certainly petition for Bankruptcy to gain preservative measures, since the procedural requirements of Special Liquidation render a timely use of these measures impossible. Secondly, while in Special Liquidation, control remains in the hands of the liquidator, usually a representative of the company being liquidated, in Bankruptcy, control is transferred to an impartial trustee. There are further many more measures relating to the availability of discovery in the Bankruptcy court. Another clear difference is that only the Bankruptcy procedure

gives the court the right of avoidance. Finally, holdouts are overridden more easily in Bankruptcy: for either the trustee has sole authority, or in special cases that are put up to a vote, a smaller percentage of claims must approve. (Table 4)

Place Table 4 here

Neither procedure is as strong as the U.S.'s Chapter 7 in its inclusion of secured claims into the procedure. Security interests are free to exercise their rights outside of both of the liquidation bankruptcy courts.

Apart from the provision of a voting rule to override holdout small claimants, Special Liquidation differs little from private settlement in that court oversight is kept at a minimum. This implies that Special Liquidation should be attempted for those private attempts at liquidation which would have succeeded but for the hold-out of a stubborn creditor. (Tozai Tosan Jitsumu Kenkyukai, 1989a: 269) Table 3 suggests that in liquidation, cases where only the hold-out issue is a problem worth court attention have been extremely uncommon in the class of large corporate bankruptcies.²⁹

3.3.2 Gatekeeping. As Bankruptcy is by far the more endowed proceeding, and the only which offers an effective stay, it is natural that gatekeeping plays a far more prominent role. Applicants must demonstrate proof of a cause of bankruptcy, and pay a substantial up-front deposit (Part 3.5.1; Table 7), whereas the deposit of Special Liquidation is minimal.

3.3 The Bankruptcy Courts for Reorganization. There are three bankruptcy courts available to the firm in Japan which wishes to restructure its liabilities and continue as a going concern: Composition (Wagi), Corporate Arrangement (Kaisha Seiri), and Corporate Reorganization (Kaisha Kosei). Composition is the most popular of the reorganization proceedings: applications for Composition constitute more than 80% of all applications to reorganization proceedings of the Tokyo Shoko sample (Table 1). In the smaller sample of large bankruptcies, it still comprises nearly three-

quarters (Table 3). While the number of Corporate Arrangement cases are somewhat larger than Corporate Reorganization cases overall, among the large bankruptcies, Corporate Arrangement applications are far less (even non-existent).

3.3.1 Governance Mechanisms. The reorganization courts share a most critical characteristic: applicants to all are eligible for the immediate granting of preservative measures, including the effective stay of creditor claims. In terms of other court powers, Corporate Reorganization, based on the old Chapter 10 of the U.S. bankruptcy code, is by far the most endowed of the reorganization proceedings. Only in Corporate Reorganization are there formal provisions for superpriority financing and avoidance, and are secured claims required to participate in the recontracting of liabilities. Further, hold-out creditors are more easily overridden: less of a majority is necessary to approve a plan than in the other two proceedings. Further, employees are given special consideration both in the formulation of the plan and the seniority of their wage claims. Most important, it is mandatory that the control of the firm and the reorganization process be transferred to a court-appointed trustee. In this respect, Corporate Reorganization is a more powerful proceeding than its current US equivalent, Chapter 11.

Place Table 5 here

Of the two remaining bankruptcy courts, which are both substantially weaker than either Corporate Reorganization or the U.S.'s Chapter 11, Corporate Arrangement is generally the stronger and more legally centralized of the two. Although not standard practice, the court does have the authority to choose a trustee to take over control if it is dissatisfied with the actions of the management and its representatives. It can also for the period of proceedings extend an act of stay such as foreclosure and repossession over secured creditors. However, it is not a uniformly stronger procedure than Composition, for unlike Composition, Corporate Arrangement does not have a voting

rule to formally override holdout creditors. Only those creditors who agree to the plan are obliged to stand by its terms. This lack of a voting rule undoubtedly accounts for the total absence of applications for Corporate Arrangement among the large bankruptcies, where some sort of voting rule to overcome the holdout problem among multiple creditors is likely to be necessary.

3.3.2 Gatekeeping. As we mentioned above, the vulnerability of the protection of bankruptcy law to abuse can require gatekeeping features both in the law and the court's application thereof. Application requirements differ between the proceedings. While in Composition, a debtor must show evidence of being at the brink of going under, the courts for Corporate Arrangement and Corporate Reorganization allow entry even if there is only a danger of insolvency or excess liabilities. The Corporate Reorganization law, intended for companies for which there is the "prospect of rehabilitation," also states that a company unable to pay its obligations "without exceedingly impeding continuation of its business" is eligible for the proceeding. (Appendix 1)

Given the stronger bankruptcy court services offered in Corporate Reorganization, and the demand that a debtor be in worse shape for Composition, what accounts for the popularity of Composition? The general answer is that gatekeeping rules to restrict abuse of the court powers are very strict in Corporate Reorganization. Pre-application screening is comprehensive, and numerous provisions now ensure that applications be in good faith. Especially since 1967, when applicants were not longer allowed to withdraw from the proceedings without court permission, and provision made for the immediate appointment of outside trustee to assume control of the firm, the opportunistic abuse of Corporate Reorganization became rare if not impossible. More specifically, in Composition the management keeps control of the company, while in Corporate Reorganization, management must be removed. As Shinjiro Takagi puts it, for a lawyer to file a petition for Corporate Reorganization is equivalent to a "request to let our client go to the guillotine." (Takagi, 1984: 8)

It is a very important characteristic of the Japanese bankruptcy system that there are clear and significant regional differences, particularly in the case of Composition, in the application of the

court's discretion in the granting of preservative measures. It is common practice of the Tokyo District Court to condition the granting of an order of preservative measures, and in particular the suspension of repayment, upon the receipt of documentation of the consent of a majority of creditors. (Tozai Tosan Jitsumu Kenkukai, 1988: 19-20) On the other hand, in the Osaka area, the courts are willing to grant the order of preservative measures without such consent. (Ibid: 68-69) This greater leniency is certainly due in part to the difficulty of private workouts because of the presence of "fixers" associated with organized crime, a subject to be discussed in greater depth in Part 4. (Ibid: 59-60; Takagi, 1990)

In fact, if it were not for the effective creditor consent requirement of the Tokyo courts for Composition applications, Composition applications would be probably be far more prevalent than they now are. In Table 6, we see a breakdown of liquidation and reorganization applications by place of application: the number of Composition applications from Osaka is consistently greater than those from Tokyo, despite having a smaller economy and fewer bankruptcies in general. There is common agreement that the creditor consent requirement, which has greatly diminished the attractiveness of Composition as a procedure in the Tokyo area. (Takagi, 1990)

Place Table 6 here

A gatekeeping feature that all of the reorganization proceedings share is a substantial up-front deposit upon application. (Part 3.5.1; Table 7)

3.4 Evidence of Discriminating Firm Alignment Among the Bankruptcy Courts. It is our proposition that the differing provisions of governance mechanisms and gatekeeping have sorted firms among the various bankruptcy proceedings so that there is a discriminating alignment of firm to procedure - one which makes best use of multiple though limited court facilities.

At this point, having surveyed the five bankruptcy proceedings, we examine once again the

large bankruptcy statistics introduced in Table 3. We have already presented explanations for the relative popularity of the proceedings. But to what extent are the characteristics of the 82 firms entering the various bankruptcy proceedings consistent with the intended sorting of the governance and gatekeeping mechanisms of the proceedings above?

3.4.1 Outstanding Debt and the Voting Rule. Total debt outstanding should relate imperfectly to the complexity of outstanding credit claims and the potential for bargaining breakdown.³⁰ As described above, voting rules is one governance mechanism that bankruptcy court offers to alleviate this problem. Since Corporate Arrangement however does not have a voting rule, we should expect few bankruptcy cases among the large sample to apply for Corporate Arrangement. In fact, there is not a single one.

3.4.2 The Debt to Paid-In Capital Ratio and Application Requirements. The debt to paid-in capital ratio is to some extent an indicator of how big a financial hole the firm has dug for itself, and how dramatic the creditor concessions must be made to continue as a going concern. We should expect to see differences relating in particular to the application requirements of the proceedings. Consistent with the fact that both Bankruptcy and Composition require proof of "causes of bankruptcy," the firm applying for those two proceedings have the highest ratios. The very low ratios of the four cases of subsidiary bankruptcies in Special Liquidation reflect both the ability to enter without "cause of bankruptcy."³¹ Finally, as Corporate Reorganization encourages applications prior to the emergence of an actual "cause of bankruptcy," and also requires a high likelihood of a successful reorganization, that its cases are far less highly leveraged than their Composition counterparts is to be expected.

3.4.3 The Location of the Corporation and Differences in Local Court Screening Practices. It was noted above that courts in the Osaka region are far more lenient in their screening of Composition applicants, in part because of their recognition of the need for prompt legal protection against the activities of organized crime. We expect more lenient gatekeeping to be

reflected in more frequent use of the procedure: in fact, while nearly one quarter of the Composition applications were from Osaka, none of the Corporate Reorganization cases were.

3.4.4. Industry, the Nature of Debt Claims, and Concentration of Firm-Specific Assets. Industry variables should serve as a significant proxy for a factor which affects the general choice between liquidation and reorganization: the nature of the firm's assets. The possibility of dealing with distress through liquidation hinges both on whether the assets in question can be redeployed to alternate uses and on whether the assets are liquid and there is a ready buyer (see Williamson 1988; Schleifer and Vishny 1991).³² In both respects, the assets of real-estate firms appear to be at an advantage.³³

Although there is not much difference between the prominence of real estate firms between the liquidation and reorganization court proceedings, the great majority of real estate firms - more than 4/5th - were **privately** liquidated. This suggests that the above factors in fact led to liquidation but were also associated with making it liquidation of a private sort, as we will see in part 4.

The path of reorganization proceeding is probably also affected by similar concerns. As discussed above and in the Appendix, Corporate Reorganization invokes the most complex centralized governance structure at the highest cost. Firms with a greater concentration of firm-specific assets should be more likely to be allowed entrance into the kaisha kosei court. In particular, we should not expect bankrupt firms in the real estate industry to end up in Corporate Reorganization, since a smaller fraction of their value will depend on their continuation as a going concern, as opposed to firms in other industries such as manufacturing or services. Indeed, none of the nine Corporate Reorganization applications were from the real-estate industry, as opposed to 15% of the Composition applications.

3.4.5 Employees as Firm-Specific Assets. Employee contracts constitute another form of firm-specific asset. Particularly in Japan, where continuous on-the-job training and quasi-

permanent labor contracts are the norm, the number of employees can very much be considered an indication of the concentration of firm-specific assets.³⁴ By logic similar to that proposed above, we should expect firms with a larger number of employees to be more likely to reorganize than liquidate.

Indeed, Table 3 indicates the reorganization court cases have a far greater number of employees on average, consistent with the notion that employee contracts are a form of firm-specific asset which can only be maintained by continuing the firm as going concern.

Among the reorganization proceedings, Corporate Reorganization is the one which offers a governance structure most equipped to preserve the value of employee contracts. In particular, the opinion of employees is actively solicited throughout the construction of the Corporate Reorganization plan.³⁵ In combination with the screening procedures of Corporate Reorganization which favor firms with large numbers of employees,³⁶ we should expect firms with many employees to be more likely to enter Corporate Reorganization as opposed to Composition. Consistent with this expectation, the average number of employees is larger in the 10 Corporate Reorganization cases as compared to 25 Composition counterparts (158 versus 131).

3.5 Common Features Which Discourage the Use of Bankruptcy Court. While there exists an alignment between the courts and the characteristics of firms entering the bankruptcy court system, it is important to recall the numerical prominence of those corporate bankruptcies which do not go to court. One factor we have already discussed - that management must cede control in the most powerful of the reorganization proceedings - undoubtedly discourages legal reorganization altogether. Although any explanation will remain incomplete until we have examined the patterns of privately managed liquidation in part 4, there are also three important features - two related to gatekeeping - which are common to all of the Japanese bankruptcy proceedings that greatly discourage their use.

3.5.1. The Advance Payment of Costs Requirement. The advance payment of estimated costs is an application requirement common to all bankruptcy proceedings in Japan. Only in Special Liquidation Now this differs very significantly from the United States, where generally

bankruptcy court costs are paid from the estate on an "as you go" basis. The result of the US practice is that the administrative costs of the bankruptcy proceedings must be covered by the state in more than two-thirds of all straight bankruptcy cases (Lopucki, 1982: 360) On the other hand, in Japan, numerous firms that might otherwise have applied to bankruptcy court, are deterred from doing so by their inability to meet the deposit requirement. (Takagi and Nakamura: 33).

Place Table 7 here

Smaller liquidation or reorganization cases are deterred by the scale of the advance payment, which does not include the cost of obtaining legal representation.³⁷ With a regressive scaling to liabilities, and a minimum deposit requirement for the smallest cases ranging from \$5000 for Bankruptcy to \$75,000 for Corporate Reorganization, smaller firms must bear substantial up-front costs to obtain bankruptcy court protection.

The deposit requirement can also handicap larger firms. Though as a proportion of liabilities, the advance payments are not so large for the larger firms (they range between 0-1% of liabilities for firms with greater than \$7.5 million in liabilities), the demands on cash flow required by the up-front payment are often a binding constraint. As recounted by practitioners, a major challenge for a company applying to Corporate Reorganization, is to withdraw the necessary cash from their accounts for the deposit without letting banks onto the fact, and setting off a general creditor panic. (Tozai Tosan Jitsumu Kenkyukai, 1989b: 63-67)

3.5.2 The Lack of Automatic Stay. While stay of the exercise of unsecured claims is automatic with application in Chapter 11 in the United States, the timing of such a stay is a matter of court discretion in Japan. That the stay is not automatic is a critical factor is supported by the fact that regional differences in granting of stay are related to dramatic differences in applications for the most popular of reorganization proceedings, Composition.

3.5.3 The Time of Court Proceedings. A general feature of the Japanese legal system which carries over to its bankruptcy courts is the limited size of the judicial plant (Haley 1978,1991; Ramseyer 1985, 627-34; 1986). The restricted number of judges and lawyers in Japan translates into a scarcity of bankruptcy judges, attorneys and trustees in particular. The institutional capacity of the Japanese bankruptcy system is further limited by background of judges. Since the civil law tradition governs, judges constitute a separate branch of the legal profession in Japan, with a generalist career path distinct from that of attorneys (Galanter, 1986: 171, Young, 1983: 533-34). As a result, judges transferred to bankruptcy court often have little exposure to general business practice, and act extremely cautiously in the exercise of their powers such as the granting of preservative measures (Takagi, 1984: 9; 1985 5-6).

Place Table 8 here

The above limitations are reflected in the time that the legal proceedings take in Japan. The representative liquidation and reorganization procedures, Bankruptcy and Corporate Reorganization, are examined in Table 8. Of the Bankruptcy cases that returned distributions and were concluded in 1989, nearly one-quarter took more than 5 years, and another quarter took between 3-5 years. Of the Corporate Reorganization cases which concluded in 1989, the median length of time from application to commencement is 3-6 months. From commencement to final approval of the plan, the median length of time taken was from 1 to 2 years, with 18% taking more than 3 years. Of course, as discussed above, court approval of the plan does not signal the end of court oversight in Corporate Reorganization. Nearly three-quarters of all the cases took more than 5 years from approval of the plan to conclusion.

4. THE GOVERNANCE OF PRIVATE LIQUIDATION

Private out-of-court settlement of business failure is the dominant practice in Japan.³⁸ One institution, the "main bank," has in a number of empirical studies been identified as a facilitator of the private reorganization of companies in financial distress.³⁹ However, the path of business failure most frequently travelled in Japan is that of private liquidation, and as we shall see, trade creditors, not banks, are the principal facilitators in settlements of this class.

Even in liquidation and without a main bank, private settlement can be better than the court alternatives in terms of time and cost. Organized private liquidations, which appear to operate in the shadow of bankruptcy law to a large extent, commonly earn non-negligible returns. However, the private ordering is not always a happy story. To the extent that there was neither the will nor means to organize the liquidation, Japanese business failures are especially susceptible to creditor panics and self-help measures which deplete the estate. Even in the organized private liquidations where creditor panic has been staved off, the inability to avoid fraudulent transfers and preferences prior to bankruptcy is an important limitation. More generally, there exist a class of criminals who often attempt to hijack the process of liquidation.

4.1 The Unorganized Liquidation In part 2, it was noted that firms highly leveraged with trade credit may not have enough assets outstanding to justify an organized liquidation. However, the capital structure of the typical Japanese firm may also be related to a reverse causality of common occurrence in Japan: creditor panic resulting in self-help measures which deplete the estate.⁴⁰

Such panic upon the bank suspension or any other news of impending bankruptcy is not too surprising coming from unsecured trade creditors, who often have more than six months accounts receivable outstanding with the bankrupt company. After all, they themselves could very easily be next: one study found almost 20% of Japanese bankruptcies to be due directly or indirectly to the bankruptcies of related companies. (Altman, 1984) As a result, creditors in Japan commonly resort to self-help measures and private seizure of the company's assets before any organized liquidation can

be arranged. The extent of these cases probably accounts for what is a common stereotype of bankruptcy of small and medium sized business in Japan: management who fear the wrath of related parties fleeing the scene, various creditors driving trucks to the factory, breaking in and fighting over goods and machines in the factory, and leaving the company headquarters either completely empty or in a ruin. (Takagi, 1988: 95-98).

In fact, Ito and Tanase document certain aspects of this image for many of the cases in their above-mentioned study. For instance, managerial disappearance is not uncommon around the time of bankruptcy. In more than half of the cases, managers had either fled the scene, or entered the hospital around the time of bankruptcy. Such managerial flight is related to later distributions, for distributions are more than twice as likely to occur if management remains on the scene. (209-210, 228). Factory raiding has also been documented. Collection or retaking of inventory, plant or raw materials, occurs around the time of bankruptcy in more than two-thirds of the cases studied in Nagoya. (217) This sort of collection is done mostly by trade creditors, and usually it is of goods which they may have previously delivered on credit to the bankrupt. Of the seized goods, more than half is later sold, while around one-fifth is kept for the seizing party's own use. Retaking of assets is not limited to cases in which there were existed security rights upon the particular seized asset. Though in 51% of the cases of seizure studied by Ito and Tanase, there exists some sort of lien such as a preferential mortgage, while 44.7% have no particular legal claim on the asset. (218-220, 226)

Evidence is that such private self-help measures often do substantially reduce the amount of assets to be distributed via more organized means. The median amount of liabilities claimed in private seizure in the sample mentioned above is 7%, or about half the return achieved in organized private liquidations. In cases when an organized liquidation of the remaining assets occurs subsequent to self-help measures, only 23.5% of the seized assets are returned to the estate. Further, distributions are far more likely have occurred in cases in which self-help seizure has not been documented.⁴(217-220, 223)

4.2 Trade Creditor-Managed Liquidation. Not all companies which fall into the private liquidation category have negligible assets upon which creditors can make claims. In addition, there are many cases in which it has been chosen to liquidate and distribute the remaining assets via private agreement among the parties involved.

What are the documented characteristics of "liquidation workouts" in Japan? In contrast to research which shows that companies which avoid legal reorganization options and reorganize privately are more likely to have a "main bank" (Suzuki and Wright), the role of "main banks," or banks more generally, is far less important in private agreements among creditors which do not result in the continuation of the company as a going concern.⁴²

This is not because companies undergoing private liquidation don't have bank credit. In fact, almost all of the companies of Ito and Tanase's private liquidation sample had obtained loans from banks; further these banks were among the largest creditors of the companies at the time of bankruptcy. However, these banks did not participate in the workout and settlement of claims. (196-197) Similarly, in a study of bankruptcies including 16 organized private liquidations in the Tokyo area in 1979-1980 by Shimojima, it was found that banks generally did not take an active role. (435: 28)

Bank reluctance to involve themselves in organized liquidation is easier to understand in the context of the standard Japanese practice among banks to request some form of collateral, including deposits, for their loans. (Corbett; Ramseyer, 1991) This request constitutes a demand in the case of emergency financing: all the companies studied by Ito and Tanase which asked for and received emergency credit from its bank had to provide security (208). When bankruptcy does occur, banks will set-off deposit and other forms of cash security against outstanding credits. When set-off does not provide sufficient return, banks will attempt to gain satisfaction from their collateral through the procedures of civil execution, though they may release it for the estate after negotiations, as discussed below. (196-197, 208-209)⁴³

On the other hand, most trade creditors are unsecured, and representatives of this creditor class play the principal leadership role in the private liquidation cases. Often these are trade creditors who have an established reputation within the industry of the bankrupt company, and who take over the management of the liquidation workout not only because of their monetary incentives to settle the matter, but improve or maintain their stature in the community. (200-202).

As organized private liquidation faces many of the same problems as a liquidation bankruptcy court, it is not surprising that certain resemblances are apparent. Like bankruptcy court, creditors meetings are held in which courses of action for the workout are discussed. The first meeting can be either called by the creditor or the debtor itself: in 59% of the cases studied by Ito and Tanase, a creditor took the lead. Around half are called within one week of the public notice of the bankruptcy, and around 50-60% of the creditors show up at the meeting. (230-231) The first meeting of the creditors usually begins with an explanation (accompanied by documentation) of the circumstances which led to the bankruptcy, and the current conditions of the bankrupt and its assets and liabilities, as well as a list of creditors. If the debtor is present, questions from creditors are received.⁴⁴ Perhaps the most important decision made at the first creditor's meeting is the selection of the creditor's committee and its chairman, usually a large and trusted creditor, though sometimes a representative of the debtor. If a creditor called the meeting, it is usually the one which becomes chairman of the committee. (230-233)

This committee, and in particular its chairman, parallel the role of the trustee in Bankruptcy or the liquidator in Special Liquidation.⁴⁵ The chairman of the credit committee subsequently requests letters of entrustment from all the creditors, and attempts to obtain the essential cooperation of the debtor in subsequent activities as well. In subsequent creditors meetings, usually around one or two over the next few months, the credit committee chairman will report to the creditors about the interim conditions of the liquidation. (230-234) The credit committee chairman is also responsible for an interim and final distribution of the proceeds of the liquidation.

The credit committee chairman, like the trustee in Bankruptcy or the liquidator in Special Liquidation, also serves as a focal point for numerous decisions concerning the liquidation of assets. Three types of assets are disposed of in liquidation. The first and most common category is debt owned to the bankrupt (in particular accounts receivable), which constitutes the most valuable of the asset categories in 40% of the cases. The recovery of these assets is commonly considered the most important job of the creditors' committee chairman in an organized liquidation, for it involves the persuasion of third parties to pay the bankrupt estate. The average recovery rate of these accounts in the cases studied by Ito and Tanase was 61%, but there were great differences from case to case. (240-241, 249-253) The second general category of assets are movables such as machines and inventory, which are usually disposed of by the creditors' committee to other creditors.

The third asset type is land, an asset in around one-quarter of the cases. Land is usually disposed of outside the creditor's committee through the legal initiative of creditors such as banks who have secured claims on it. But there often occurs negotiations between the creditors' committee and the bank for the land's release to the estate in return for some sort of compensation. (Takagi and Nakamura:108-109, 230-232) In particular, when the market value of the collateral far exceeds the amount of the secured obligation, the creditors' committee will try to locate a purchaser, sell the property with the consent of the secured creditor and retain the balance for distribution to other creditors, after payment to the secured creditors. (Hiscock and Sono: 775)

The chairman also parallels the trustee in Bankruptcy in its role as an evaluator of credit claims. Typically, forms for the report of credit claims are sent to all known creditors to be filled out and returned to the chairman. (For example of form, see Takagi and Nakamura: 97) Inconsistencies between the debtor's books and the claims submitted can lead to an investigation, which in Nagoya occurred in more than half of the cases which resulted in credit committee meetings. Further, the creditor's committee also serves as a forum for protests over claims. In seven cases, there were objections raised to certain credit claims, and six of those cases resulted in a dropping of the disputed

credit claim or withdrawal of the protest. (Ito and Tanase: 236, 244)

The power to restrain hold-out creditors is of course more limited in private reorganization than the two bankruptcy court for liquidation since neither stay measures nor voting rules apply. The credit committee chairman is responsible for determining the appropriate response to private legal action by non-cooperative creditors, which can include agreeing to treat them preferentially, having assets transferred to the credit committee chairman, or as a last resort, applying for one of the bankruptcy courts. (Takagi and Nakamura: 125-129)

One key power in which the credit committee forum is merely a shadow of the stronger of the liquidation courts, Bankruptcy, is in the ability to undo prior claims which are illegitimate. As mentioned earlier, private self-help measures are common at the time of bankruptcy. Further, immediately prior to bankruptcy, cases where unscrupulous creditors took advantage of the debtor's perilous condition to demand transfer of goods, collateral, or preferential repayments are not uncommon. More specifically, there is documentation of the involvement of organized crime in 23.1% of all liquidation cases. (Ito and Tanase: 214-215) To some extent, the persuasive power of the chairman to reverse prior activities is effective. In the 23 cases when there was clear seizure of assets to which there was no legal claim, the creditor committee was able to obtain the return of the assets in 6, or 27.3% of the time. However, the extent of the cases which remain unresolved reflects the lack of legal power residing in the credit committee. (Ito and Tanase: 242)

This lack of power to counter fraud accounts in part for those shifts to legal bankruptcy that occur after the creditor's committee meeting in 18% of the cases. Of related interest is the fact that 35% of all cases in which organized crime was involved go to Bankruptcy, which only 9% of the other cases go to Bankruptcy. (248)

Nonetheless, despite all of the problems with private trade-creditor led solutions, positive results are evident. In those 40% of the cases in which distribution occurred in Nagoya, the average distributions were 19.4% (median 14%), somewhat higher than the documented returns for

Bankruptcy cases. When combined with estimates of seized distributions prior to settlement, the average settlement rate is about 21%, which 79% of the recipients surveyed were either satisfied with or thought appropriate. The rate for the Tokyo cases was smaller (12.2%), but as the cases selected were in progress, these distributions often were of a preliminary nature and were not judged by the author to be significantly different from those of Nagoya. (262; 435,30-31)

Not surprisingly, time appears to be saved by the private handling of liquidation. In the Nagoya cases, when there were positive proceeds distributed to creditors, it took an average of 5 months (median 3.5 months) to reach the conclusion of the case. In Tokyo, the average among cases which had run to conclusion was 65.5 weeks, or more than three times those in Nagoya. However, even the Tokyo figures are shorter than the time taken for the typical Bankruptcy case. (267; 435,31-32)

Thus, organized private liquidation is often successful in Japan, a quick and cost-effective alternative to bankruptcy court. Table 8 summarizes the above discussion, with a list of the important similarities and differences of the organized private liquidation with the strongest and most popular liquidation-based bankruptcy court, Bankruptcy.

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4.3 "Fixer" Managed Liquidation. It is no secret that gangsters in Japan aggressively extract control rents from the corporate managers of Japan, both through specialists (sokaiya) who will disrupt general shareholders' meetings (or at a price protect the peace instead) and otherwise blackmail directors with embarrassing information, and through green-mailing and related stock-cornering speculative groups. (Isaacs and Ejiri: 124-128)

Perhaps less well-known in the West is the equally pervasive role that organized crime plays in the handling of corporate financial distress in Japan.⁴⁶ There exist professionals in Japan outside

the legal community and intimately associated with gangster groups, which specialize in measures involving the reorganization or liquidation of financial distressed firms. They are commonly known as seiri-ya, roughly translatable as "fixers," although other terms are also occasionally used.⁴⁷

According to a Japanese lawyer who has investigated their history, the first prototype of a "fixer" company emerged in Osaka in 1953, specializing in the collection of debts of financially distressed companies, buying up dishonored bills at a discount from creditors. Imitators soon emerged, and by 1965, companies were offering more general bankruptcy services such as the protection of corporate assets, and the management of credit claims. In 1976, there were 20 companies whose business was concentrated in Osaka. But by 1979, their number had increased to between 60-80 companies, and a good number had advanced into Tokyo. But the so-called eight industry leaders were all located in Osaka.⁴⁸

A "fixer" can be employed by either the debtor or creditors. "Fixers" often approach the debtors first, offering to protect it if allowed access to the books, the corporation's stamp, and other control rights. The stick as well as the carrot serves as an entree: convincing the debtor to employ their services is often facilitated by the threatening presentation of an overdue credit. Another route is through demonstrating expertise and asserting leadership at the first general creditor's meeting after the bankruptcy, and being elected chairman of the creditor's committee. (Miyazaki:17-18; Takagi, 1988:140)

To some extent, "fixers" substitute for lawyers in the management of bankruptcy since they often have expertise in preparing the documentation of liquidation and purport to represent the interest of their employer in resolving conflicts with other parties. (Takagi,1988: 141)⁴⁹ However, the large players bring an array of tools that go beyond conventional legal services.

For one, their documented links with gangster groups facilitates the extraction of concessions from debtors or creditors through the implied use of force. For instance, means of intimidation such as the occupation of corporate headquarters are not uncommon. Threats of force can also assist in

increasing the value of the estate, for instance, in the retrieval of debts owed to the bankrupt estate by stubborn debtors. In addition, many "fixers" include under their corporate umbrella companies which specialize in the rapid disposal of real estate and other goods of the bankrupt. In particular, seiri-ya are skillful in obtaining the release from banks of collateralized land and disposing of it quickly. (Takagi: 140-142)

There are a variety of ways in which "fixers" can skim off their share of the proceeds. On the asset side, inventory or collected accounts receivable can be embezzled. On the liability side, credits can be created to their related companies which receive the same returns as the original creditors. More complicated means include: (1) The liquidation of company assets through related companies at artificially low prices; and (2) The creation of leasing rights on the bankrupt's land to affiliated companies which subsequently must be paid off to give up their rights (protected under Article 395 of the Civil Code) for liquidation. All of the means of ensuring compensation are facilitated by the fact that the leaders of the industry also specialize in the manipulation of accounting books, with the industry leaders employing accountants and other specialists.

Once "fixers" have their foot in the door, dissatisfied parties generally have little recourse other than to apply to one of the bankruptcy courts for court supervision. (Takagi, 1988: 144) In Bankruptcy, the appointment of a trustee and supervision of the assets follows relatively quickly upon preservative measures (1 week to 2 months). However, the unscrupulous "fixer" can pre-empt such a strategy by making the debtor apply for Composition, Corporate Arrangement, or Special Liquidation whose court oversight is much weaker than that of Bankruptcy. Applications for these procedures automatically cancel or preempt any outstanding application for Bankruptcy, the first goal.

Between application and the start of the aggressive involvement of the court in the procedures of Composition and Corporate Arrangement, there is normally a period of three to six months, during which time the "fixers" can continue much of their business, subsequently withdraw the application prior to formal initiation.

The actions of "fixers" can be viewed in two lights for the purposes of this study. First, just as trade-creditor managed pattern of organized private liquidation described above, the "fixer" in Japan may serve as a substitute mechanism for legal bankruptcy procedures to resolve the problems of financial distress. In column 2 of table 10, interpretations of their activity consistent with the service of a "fixer" as a substitute for the trustee in Bankruptcy are given. On the other hand, "fixers" in Japan can be viewed as a parasite of financial distressed firms and their creditors, more of a vulture than an intermediary, exploiting conflicts of interest and a desire for privacy to extract rents more than create value, and imposing an absolute cost on all privately-led liquidations.⁵⁰ The negative spin on "fixer" activity is given in the third column of Table 10.

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4.4 Evidence of Discriminating Firm Alignment Between Private and Court-Based Liquidation Procedures. We turn to our sample of large bankruptcies for one last time (Table 3). Just as much as there was evidence of a discriminating alignment between firm characteristics and the various proceedings within the bankruptcy court system, we should expect those 103 liquidation cases which were resolved privately to be noticeably different⁵¹ in certain characteristics from those 47 liquidations resolved in bankruptcy court.

4.4.1 Outstanding Debt and the Collective Action Problem. As reviewed in part 3.4, total debt outstanding should relate imperfectly to the complexity of outstanding credit claims and the potential for bargaining breakdown. Since bankruptcy court offers one way to alleviate the collective action problem, we should expect court-based liquidation cases to have larger amount of liabilities outstanding. In fact, the average total debt is nearly 20% higher in the court-based liquidation cases.

4.4.2 The Location of the Corporation and the "Fixer" Effect. We have already discussed two hypotheses concerning the role of "fixers" in the bankruptcy process. As noted above,

provision of many distinct bankruptcy courts,⁵⁵ which offer varying degrees of protection to the debtor. A complementary approach has been the maintenance of strict gatekeeping procedures - particularly for the strongest proceedings - both to optimize the amounts and form of court use, and encourage the reliance on private institutions whenever possible.

Based on our empirical evidence, we conclude that there exists in Japan an efficiency-based discriminating alignment of business failures with governance structures - both among the different courts and between the bankruptcy courts and private institutions. Characteristics of the firms which have applied to the various bankruptcy courts differ in the expected manner - while business failures are less likely to enter bankruptcy court when their firm-specific characteristics are less well suited to the services bankruptcy court can provide.

Ideally, private institutions which act "in the shadow of the law" should pick up many of the business failures which do not make it to bankruptcy court. Indeed, we have presented evidence that trade-creditors often step in to organize liquidations. However, patterns of liquidation which operate outside of the law's shadow are apparent as well. The extent to which this is an indicator of a major flaw in the system, rather than the relatively unimportant consequence of the many no-asset bankruptcies in Japan, remains an important topic for future research.

APPENDIX 1

THE ORIGINS AND GOVERNANCE FEATURES
OF THE JAPANESE BANKRUPTCY COURTS

In this appendix, we provide details concerning the evolution and those governance features of the five bankruptcy laws which relate to the comparisons of Part 3. Those readers desiring a wider range of detail concerning the Bankruptcy and Corporate Reorganization proceedings are referred to Schumm (1988) and Matsuo (1985a,1985b).

1. Bankruptcy (Hasan).

Origins. In historical Japan, there was traditionally no written law governing the resolution of business failure.(Matsuo, 1971) However, as part of the modernization and adoption of Western institutions during the Meiji era, a statute governing the liquidation of insolvent firms was introduced in 1872. This was followed in 1893 by a bankruptcy statute in the Commercial Code based on a draft written by a German advisor, Herman Roesler, which was based on the French concept of bankruptcy, wherein the bankruptcy provisions only applied to merchant.⁵⁶ When the Civil Code and Commercial Code were modified to be closer to German provisions in 1923, a new bankruptcy law (hasan-ho) based on the German approach was also enacted at that time.⁵⁷ The single most significant revision of the law came during the American occupation in 1952, when the American concepts of corporation law and the provision of discharge were introduced.⁵⁸

Application Requirements. All debtors are eligible for hasan proceedings, and petitions may be made by either the debtor or creditors. (Art. 132) Two causes of bankruptcy are recognized by the law: insolvency, or an inability to cover indebtedness, and an excess of liabilities over assets. (Arts. 126-127). Upon accepting the petition, the court will only render an adjudication for bankruptcy if one of these causes is met. A typical proof of cause of bankruptcy to be presented at the time of bankruptcy petition would be a dishonored promissory note. A important procedural requirement to be met at the time of application is the advance payment of costs. (Art. 139)⁵⁹ In practice, the payment required is scaled to liabilities, and ranges from 0.7 billion to 4 million yen. (\$5,250-\$30,000)

Preservative Measures and Stay Orders. Immediately after the filing of the petition, the court usually issues an order for standard preservative measures, even prior to the adjudication of bankruptcy (Art. 155). Typical preservative measures include a provisional attachment of inventory and other movables, a provisional disposition prohibiting a change of holder of immovables, and a provisional injunction prohibiting payments. Preservative measures are often critical in staving a panic and a flood of individual recollection efforts by creditors.

Upon an adjudication for bankruptcy, general creditors are automatically stayed in enforcing their claims except through bankruptcy procedure: Individual applications of levy or execution cannot be allowed and any prior proceeding which is pending at the time of commencement of the case is voided (Arts. 16, 70). However, secured claimants are granted the right of separation of their security interests, and may exercise their rights outside of the bankruptcy proceedings. (Arts. 95) In general, the rights of set-off outside of the bankruptcy proceedings are also protected. (Art. 98)

Management and Control of the Estate. Upon the ruling for commencement of bankruptcy, the debtor is immediately forced to relinquish all control rights to a court appointed trustee who has

the exclusive right to manage and dispose of the bankrupt estate (Arts. 7, 157, 185).⁶⁰ The trustee appraises the assets and prepares an inventory and balance sheet for submission to the court. (Arts. 188-189).

Distribution of the Proceeds. The trustee also examines and verifies debt claims which are submitted to the court within a prescribed time period. On the day of claim investigations, related parties can offer opinions and make legal objections. (Chapter 7). The trustee carries out the liquidation of the assets and distributes them on the basis of the equality principle: i.e., obligations of the same rank of priority are paid in proportion to the amount of the respective claims (Art. 40). In general, there is no overall plan to be approved, though important administrative matters such as the granting of allowances in aid and the sale of may be brought up for resolution and approved by a simple majority of claims (Arts. 179,194,197).

Among the liquidation courts, the distribution only of hasan returns is reported regularly in the statistics published by Supreme Court. The median return to the unsecured creditors is around 10-15% of the original claim. These figures are if anything larger than those that emerge from legal liquidation in the United States.⁶¹

The Availability of Discovery. The court has the power to question the debtor and its directors and representatives concerning the bankrupt. (Art. 153). In addition to putting the debtor and its directors under surveillance, restrict their travel and communication, and opening their mail, the court may enforce discovery by ordering their arrest if they are viewed as uncooperative. (Arts. 147-150, 190)

Avoidance. In hasan, the trustee has the power to obtain the avoidance of a wide variety of preferential and fraudulent transfers done since the petition or suspension of payment.⁶² Further, the trustee can go back to avoid acts prior to petition or suspension if there was "knowledge that it would prejudice creditors in bankruptcy" of the bankruptcy and beneficiary party. (Art. 72(1)) Even without knowledge on the part of the bankrupt, in the case of the furnishing of securities or extinction of obligations which do not pertain to the duties of the bankrupt, the court may go back to avoid actions taken 30 days prior to petition or suspension; in the case of "any gratuitous act ... done by the bankrupt," the court may go back 6 months. (Art.72(4-5))

2. Special Liquidation Under the Commercial Code (Tokubetsu Seisan).

Origins. In 1938, two additional bankruptcy codes which only applied to stock companies were introduced into the revised Commercial Code, one each for liquidation and reorganization respectively. The newly introduced liquidation procedure, tokubetsu seisan, drew somewhat on contemporaneous U.K. corporate law⁶³, and was intended to provide a less cumbersome alternative to hasan. To avoid the time and expense of hasan, many bankrupt companies at that time were using the standard liquidation procedures governed by the commercial code which were intended for solvent enterprises only. Partially to provide a framework in which a court could oversee an insolvent's liquidation for the protection of creditors, while simultaneously preserving the relative simplicity to attract applicants discouraged from hasan, tokubetsu seisan was developed. (Aoyama, 1990b: 379-382)

Application Requirements. Like hasan, potential applicants include both the debtor and creditors. However, in contrast to hasan, tokubetsu seisan is available only for stock companies which are already in the process of ordinary liquidation.⁶⁴ Further, acceptable causes for application are

broader than those of hasan: an acceptable cause exists when there is a suspicion that a condition of excess liabilities exist, or "it is deemed that circumstances exist which would seriously impede the carrying out of the liquidation," (Art. 431), which can be interpreted to mean cases where multiple creditors make the successful operation of ordinary liquidation difficult (Aoyama, 1990b: 384) The advance payment of costs required is usually lower than that of hasan, as estimated costs are lower, for reasons which will become clear below.⁶⁵

Preservative Measures and Stay Orders. Even before the application for tokubetsu seisan, an effective stay order of debt repayment is applicable during the presentation of claims of ordinary liquidation (Commercial Code, Art. 421). As in hasan, the court may issue standard preservative measures immediately upon application, and may also suspend any executory process in progress which affects the assets of the corporation.

However, certain procedural requirements greatly dilute any impact the preservative measures of tokubetsu seisan could have in preventing a panic among creditors. Since any resolution to dissolve the company in ordinary liquidation (which must precede tokubetsu seisan) has to be put up to a vote at a shareholder's meeting, and notice of this resolution must be sent out two weeks prior to the meeting (Art. 232), a filing for tokubetsu seisan to obtain preservative measures before the state of the firm becomes public knowledge is not generally feasible. Only for small, closely held companies which can obtain a waiver of the shareholder notification requirement, can a timely filing for tokubetsu seisan be envisaged. (Takagi and Nakamura: 24)

Stay orders become automatic upon the rendering for the commencement of proceedings by the court. (Art. 432-433). Unlike hasan, stay orders can extend to the execution of security interests.⁶⁶ Although the priority of secured claims is not changed by the proceeding, the law does allow the liquidator to require them to join in the drawing up of any agreement. (Arts. 433,439-40,449)

Management and Control of the Estate. The most critical distinction between hasan and tokubetsu seisan lies in the delegation of responsibility for the liquidation. The liquidator remains the individual who was elected by the shareholders to manage the ordinary liquidation (Art. 434), and is ordinarily either a director of the company or a legal representative thereof. This liquidator is the one who prepares an inventory and balance sheet for the court, and examines credit claims (Arts. 419). However, the liquidator is obliged to impartially and faithfully discharge the business of liquidation based on the equality principle (Arts. 434,438), and remains under the supervision of the court which may replace him for cause. (Art. 435)

The Distribution of the Proceeds. Unlike hasan where the distribution of the proceeds from liquidation occurs automatically, in tokubetsu seisan, after the examination of credit claims (Art. 421), the liquidator submits a draft plan for debt repayment to the creditors' committee for approval, which must be approved by three-quarters by value of creditors and by the court (Art. 450). In this plan, special arrangements are possible for the preferential treatment of small claims (Art. 448).

3. Composition (Wagi).

Origins. In 1923, the composition act, wagi-ho, intended for the reorganization of the bankrupt, was enacted concurrently with the new hasan-ho. Unlike hasan, the country which formed the basis for the Composition Law was not Germany, which had no separate code for reorganization, but rather the Austrian Composition Code, which had been formulated in 1914. According to one view,

a separate composition code was deemed necessary in Japan because hasan incurred such harm on the reputation of the debtor that forced composition under the hasan code was not a practical alternative for the debtor desiring continuation as a going concern. (Asagami and Taniguchi: 14-16)

Application Requirements. Like hasan, all debtors are eligible for hasan proceedings, but unlike hasan, only debtors are eligible to file a petition, which must include a plan of composition, which usually provides for the deduction of debts and the extension of maturities. There should exist one of the causes of bankruptcy (as defined in hasan), which basically limits applicants to those that are on the very brink of going under. As with the other bankruptcy courts, an advance payment of costs is required (Art.14), which ranges in the published guidelines between 2-5 million yen (\$15,000-\$37,500). (Table 7) Wagi has explicit provisions in the law spelling out grounds for dismissal of the application if the debtor is judged not to be bona fide, or even if the terms "are contrary to the general interests" of the creditors. (Arts. 18-19)

Upon application, the court appoints an adjustment commissioner to investigate the finances of the debtor and submit a written opinion concerning feasibility of the debtor's plan and whether composition (Art. 21). When the court finds that the proposed plan is feasible and in the best interests of creditors, it may render an decree for commencement.

Preservative Measures and Stay Orders. Immediately after filing of the petition, the court may, upon request of the debtor or of its own motion, issue an order of preservative measures (Art. 20). As a practical matter, it is often critical to obtain preservative measures to stave off a creditor panic, as well as avert the suspension of bank transaction by the clearinghouse. The ruling for commencement prohibits all further compulsory executions, provisional attachments or provisional dispositions levied or ordered on the assets of the debtor and suspends all such measures already undertaken. (Art. 40)

However, unlike hasan, or as we will see, kosei wagi does not prohibit payments to creditors outside the proceedings: i.e., there is no article which states that claims in bankruptcy may not be enforced except through the bankruptcy procedure, neither is the equality principle in the law. Further, stay orders do not apply to secured creditors, who are in principle free to exercise their security rights outside of the wagi court. (Art. 43)

There have developed very clear and significant regional differences in the application of the court's discretion in regards to the granting of preservative measures in wagi. It is common practice of the Tokyo District Court to condition the granting of an order of preservative measures, and in particular the suspension of repayment, upon the receipt of documentation of the consent of a majority of creditors. (Tozai Tosan Jitsumu Kenkukai, 1988: 19-20) On the other hand, in the Osaka area, the courts are reportedly willing to grant the order of preservative measures without such consent. (Ibid: 60-61)

Management and Control of the Firm. Unlike hasan, control of the firm is not transferred to a trustee. Both before and after the commencement of composition, the debtor's right to manage and dispose of his assets remains intact. The trustee that is appointed upon commencement provides little more than an oversight role; for example, he must consent to acts outside the ordinary course of business. (Art. 32(1))

The Availability of Discovery. The debtor must cooperate with the investigation prior to the

order for commencement, and the adjustment commissioner has the power to call the debtor and its directors and representatives in for questioning. (Arts. 22-23) Upon commencement, similar powers rest with the trustee. (Art. 37) At the meeting of the creditors which follows the commencement, both the receiver and adjustment commissioners report their findings concerning the state of the debtor and the terms of composition. (Art. 48).

The Approval and Performance of Repayment Plans. Fundamentally, the construction of the composition plan is the responsibility of the debtor. The equality principle does not hold: although there is a procedure for the filing and verification of claims to the trustee (Arts. 41-45), this is only for the determination of voting rights. The plan is put to a vote at the meeting of creditors and accepted when a majority of creditors present at the meeting holding three-quarter of the allowed claims consent and the court approves. (Arts. 49-50) If approved, the proposal is binding on the general body of creditors, though it cannot affect secured creditors (Articles 50,54). If it fails to obtain approval, the process will be converted into a bankruptcy proceeding. (Arts. 9, 59)

Although there exists the legal proviso that concessions in the wagi plan can be annulled by reason of non-performance (Art. 62), the court supervision ends with the approval of the agreement. which means that monitoring to follow-up on whether the debtor actually fulfills the agreement does not occur under the court aegis.

Avoidance. Unlike hasan, the trustee has no power to avoid transactions detrimental to the general creditors concluded shortly before application. Claimants who want to recover assets which were lost from the company due to fraudulent activity, must rely on the general principles of the civil code. (Art. 424)

4. Kaisha Seiri (Reorganization under the Commercial Code). *Origins.* One of two additional bankruptcy codes introduced into the revised commercial code in 1938 was a reorganization procedure. According to one of its authors, the Corporate Arrangement Law (Kaisha Seiri Ho) was drafted with slight reference to the rules in U.K. corporate law for arrangements and reconstruction under court supervision, as well as procedures in the Swiss Debtor Law.⁶⁷ (Aoyama, 1990a: 114) The primary impetus for drafting kaisha seiri was to provide a reorganization alternative to wagi and thus increase the use of legal proceedings by stock companies in bankruptcy, and reduce the number of questionable private settlements. (Takagi, 1983: 44)

Application Requirements. In a significant departure from wagi, where the required bankruptcy causes are so similar to hasan to be almost contradictory to wagi's status as a reorganization procedure, kaisha seiri allows entry even if there is only a danger of insolvency or excess liabilities. Applications for kaisha seiri may be made by the debtor, or creditors or shareholders with holdings above 10 and 3 percent respectively. (Art. 381). As in the previous proceedings, an advance payment of costs is required upon application, usually far above that of wagi cases (Table 7).

Upon application, the court appoints an inspector to investigate the state and possibility of rehabilitation of the corporate debtor, as well as other opening requirements. After receiving the inspector's report, the court renders the opening decree if the requirements are met. (Art. 386; Takagi, 1983: 12) Where the court deems that reorganization is not possible, the process is converted to a hasan proceeding. (Art. 402)

Preservative Measures and Stay Orders. Upon application the court may, if it is deemed necessary, issue an order of suspension of any executory process in progress which affects the assets

of the corporation. Preservative measures to guard against the disappearance of the bankrupt's assets are also possible. Once an order for the commencement of the proceedings has been made, the suspension of executory procedures becomes automatic. In the second significant departure from wagi, the stay can be extended to secured creditors and acts such as foreclosure and repossession to realize mortgages and liens if it is "in accord with the interests of the creditors in general." (Arts. 383-386)

Management and Control of the Firm. In principle, there is no transfer of control of the firm away from existing management. Similar to wagi, the court can appoint a supervisor who oversees management activity. (Arts. 386(1.10), 397) In addition, unlike wagi, the court does have the discretion to appoint a receiver to take over the management of the company (Art. 398), though in practice this rarely occurs.

The Availability of Discovery. According to article 390, the inspector may demand from any employees or representatives of the company a report on the affairs of the company, and may inspect its books and documents. If cooperation is not forthcoming, the inspector may obtain the assistance of a bailiff and the local police.

The Approval and Performance of Repayment Plans. The plan drafted by the corporate debtor or the trustee must be presented within the period designated by the court, which is usually six months following the opening. The supervisor, if appointed, assists the corporate debtor in drafting the plan, which provides for the deduction of debts or the extension of maturities. (Art. 391; Takagi, 1983: 12)

As in wagi, there exists no equality principle constraining the plan. However, unlike wagi, there also exist no voting rules (and thus no provisions for the filing or verifying claims). Although the court generally will issue an order to execute the plan when 90% or more of the creditors agree (Bank of Japan, 1989), dissenting creditors are not bound by the plan.⁶⁸ Efforts are usually made to include secured creditors in the construction of the proposed plan, in which a partial write-off of their claims occurs. (Tozai Tosan Jitsumu Kenkukai, 1989b: 311-312)

The final important distinction from wagi is that the court does not close the case until all or substantially all the payments provided for in the plan have been made, and continues to supervise the debtor's performance during that time.

Avoidance. Kaisha seiri has no special provision for avoidance by the court. Thus, as in wagi, to recover assets which were lost from the company due to fraudulent or preferential activity, any claimant must rely on the general principles of the civil code, Article 424. Though avoidance rights are not specified in kaisha seiri, the court does have the ability to assess claims for damages against corporate directors. (Art. 386(8))

5. Corporate Reorganization Law (Kaisha kosei)

Origins. In 1952, along with the revision of the hasan-ho, Japan's fifth and final bankruptcy code, the Corporate Reorganization Act (kaisha kosei-ho) was introduced. This law, also available only to stock companies, was modeled after Chapter 10 of the U.S. Bankruptcy Act (1938).⁶⁹ The most significant revisions of this law came in 1967, which introduced a voting rule for secured creditors, and allowed for the court to appoint investigators and an interim trustee before the commencement of the proceedings. (Arts. 40, 101) The revision also aimed at eliminating abuses

of the kaisha kosei court, by disallowing the withdrawal of petitions after the granting of preservative measures without court approval (Art. 44).

Application Requirements. Kosei is intended for stock companies for which there is "the prospect of rehabilitation." (Art. 1) While like kaisha seiri, an application may be filed upon the danger of insolvency or excess liabilities, kosei also allows entry if a company is unable to pay its obligations "without exceedingly impeding continuation of its business." (Art.30). Applications for kosei may be made by the debtor, or creditors or shareholders with claims or shareholdings above 10 percent of capital. (Art. 30(2)). The advance payment of costs is required upon application generally exceeds those of the other reorganization proceedings, and usually ranges between 10 to 30 million yen(\$75,000-\$225,000). (Table 7; Tozai Tosan Jitsumu Kenkukai, 1989b: 66-67) Like wagi, kosei has numerous provisions explicitly spelling out grounds for the dismissal of application judged not to be bona fide. (Art. 38)

Upon application, the court appoints an interim trustee (or investigators) to investigate the condition of the corporate debtor, and the court will render the opening decree if there is a reasonable prospect for rehabilitation and the other requirements are met. (Takagi, 1984: 14) Normally, the period between the filing of an application and the court's adjudication ranges from 3-6 months. (Table 8)

Preservative Measures and Stay Orders. As with seiri, the court may issue an order along with standard preservative measures for the suspension of an executory process which affect the assets of the corporation, including the enforcement of security interests and tax liens. (Arts. 37-39) Once the court rules in favor of the commencement of reorganization, the stay which extends to secured creditors becomes automatic (Art. 67-68).

Although stay of secured creditors claims is a feature of other bankruptcy procedures, only in kosei are secured creditors required to participate to receive performance and submit their claims to revision. (Art. 123). The right of set-off is unaffected in reorganization, but unlike the other bankruptcy procedures, it must be exercised within the period for the report of claims (Art. 162).

Management and Control of the Firm. From the perspective of those who wish to compare Japan's strongest and most US influenced bankruptcy procedure with Chapter 11, undoubtedly the principal difference is that the debtor is not in possession. It is mandatory that the court appoint one or more trustee to take over the management of the estate, and that the officers, directors, and owners be removed. Since the 1967 revisions, soon after petition a transfer of control to occurs to a court appointed interim trustee. At the time of the ruling for commencement, the court-appointed trustee takes exclusive control: charged both to manage and dispose of the assets as well as administer the business (Art. 53). In large cases such as Sanko Steamship or Riccar, the appointment of two (or more) specialized receivers to divide the legal and management responsibilities is common. (Ito: 21, Steward, Petach) Article 54 provides for court supervision of the receiver(s).

The Availability of Discovery. Immediately following the application, the court calls the representative of the company in for questioning. (Art. 36) To supplement the transfer of control, the interim and regular trustee may at any time request any employee of the company to make reports on the circumstances of the company business and assets. (Art. 43, 98(2))

The Approval and Performance of Repayment Plans. As preservation of equality among debtors

of the same rank is a requirement of the plan (Art. 229), there is a procedure for the filing for verification of claims of both unsecured and secured creditors to the trustee. The determination of the extent of secured claims is determined based on the going-concern value of the property in which the secured creditor has an interest. Claims not filed within the time limit are rejected, and claims are confirmed at a creditors meeting. The plan is drafted by the trustee (Art. 53), and must be presented within the period designated by the court, which is usually one year following the commencement, although an extension of the period may be granted with cause. (Takagi, 1984: 15) Although payments to creditors outside the proceeding are in principal not allowed (Art. 112), kosei is unique among the bankruptcy procedures in containing provisions for claims which arise subsequent to commencement to be paid in preference to reorganization claims, the equivalent of superpriority in the U.S. context. (Arts. 208,209) Further, the court may allow client small and medium-sized companies to be paid before reorganization is complete. (Art. 112 (2))

Another key distinction of kaisha kosei from the other reorganization proceedings is the treatment of the claims of employees of the bankrupt. Collective bargaining agreements are not construed as executory contracts which the trustee has the option to reject, and the payment of employee claims is further assured by their classification as "common obligations" payable before other reorganization obligations. This is in stark contrast to hasan or wagi where wages are not given a lower status than common obligations. (Hiscock & Sono, 1980: 774). Further, the opinion of employee representatives with regards to the plan is actively solicited. (Art. 195)

The required majorities for the approval of the reorganization plan are two-third in value of the unsecured claims, and four-fifths for the secured claims.⁷⁰ (Article 205) If, as in almost all kosei cases, the debtor is shown to be insolvent, shareholders have no right to vote and obtain no compensation. (Article 129; Takagi, 1984: 15). The voting rules are supplemented by provisions which allow the court to approve a reorganization plan even if there exists groups dissenting, but in practice, negative votes which necessitate the use of a cramdown are extremely rare (Art. 239; Matsuo: 37).

Just as in kaisha seiri, the case is not closed by approval of the plan. The trustee is charged with the implementation of the plan (Art. 247), makes monthly reports to the court, and the court does not rule for conclusion until nearly all of the payments as called for in the plan have been made. (Takagi, 1984: 16)

Return data are not published by the Supreme Court for the reorganization plans, but it has been estimated that general unsecured creditors in kaisha kosei get around 20-30% of their original claim (Bank of Japan, 1989), percentages similar to those documented in the United States.⁷¹

Avoidance. The court's power of avoidance in kosei is nearly identical to that in hasan. As in hasan, the trustee may avoid a wide variety of preferential transfers and fraudulent conveyances, and go back prior to petition if there "was knowledge that it would prejudice" other secured or unsecured creditors on the part of the bankrupt and beneficiary party. (Art. 78) Even without knowledge on the part of the bankrupt, they can go back between 30 days to 6 months for certain classes of preferential acts (see hasan section, above).

ENDNOTES

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¹ Most notable and controversial are the recent articles by Bradley and Rosenzweig in the April 1992 Yale Law Journal, and a companion shorter piece in the New York Times, March 8, 1992.

² Though some believe that abusive filings of this sort can usually be limited by court action, Congress, and market forces, as Nelson puts it, "it is clearly impossible to eliminate the potential for some abuse, particularly given the protection now offered by the corporate veil and existing prohibitions on indentured servitude." (1991) For a discussion of the pro and cons of giving preferences to potential targets of an abusive filing, see the discussion in Nelson (1991) and the literature cited therein.

³ See Bradley and Rosenzweig(1992a, 1992b), or the Economist (1991). The empirical research of Franks and Torous (1989,1991), Weiss (1990), Gilson et al (1990), and Eberhart et al (1991) have all found that deviations from absolute priority occur as a practical matter, consistent with the theoretical implications of debtor control of the Chapter 11 process (Bergman and Callen; Bebchuck and Chang). On the other hand, the research of LoPucki and Whitford (1990) did not find significant deviations from absolute priority.

That deviations from absolute priority engender "social costs," though often presumed by Chapter 11's critics, is an even more unsettled issue. For evidence that the market discounts expected violations in the pricing of publicly held debt, see Eberhart (1992). For a cogent statement of the view that there is little wrong with lack of adherence to absolute priority when creditors and bondholders make their investment decisions correctly informed of that likelihood, see Altman (1992).

⁴ For instance, it has recently been suggested that the U.S. bankruptcy courts construct appropriate categories of "abuse" and "good faith" in order to turn back undeserving candidates. (Hillman) Buschman et al and Weiss have proposed to limit the "exclusivity period" (the time during which the debtor has the sole right to propose reorganization plan), in an effort to limit debtor control of the bankruptcy process.

⁵ Bradley and Rosenzweig propose to replace the Bankruptcy Code with a process which allows successive classes of claimants (starting with the most junior) to either bid for the chance to pay off the unpaid debts or give up their claims. If the process reaches the senior creditors, they can either take over the firm to either manage, sell, or liquidate. The idea of an auction for new equity of the bankrupt firm, though without the abandonment of reorganization law altogether, is not entirely new (Roe, 1983).

⁶ More generally, it is now standard in the law and economics literature to posit that the set of rules known as bankruptcy law has an efficiency justification. For some recent interpretations of bankruptcy law as motivated by efficiency considerations, see Easterbrook (1990), Webb (1991), Nelson (1991) or Milgrom and Roberts (1992).

⁷ For an overview of the policy issues in the context of personal bankruptcy, see Sullivan et al (3-14). For a more recent overview which concerns specifically the Chapter 11 debate, see Altman (1992), or Buschman et al (1991).

⁸ That gangsters often obtain entree immediately prior to bankruptcy suggests that the presence system incurs near-default costs. On the other hand, the slowness of Japan's legal system can be viewed as beneficial in the context of diminishing wasteful rent-seeking through legal channels (Ashenfelter and Bloom; Baumol)

⁹ A comparative study by Altman found the number of business bankruptcies in 1980 per population and GNP either equivalent or slightly higher than in the United States (Altman: 174). In the late 1980s, the relative number of bankruptcies in the U.S. increased relative to Japan. (Frankel and Montgomery: 264)

¹⁰ Although the business failure data published by Dunn and Bradstreet consist of an aggregate of the sum of bankruptcy court applications and business failures which are handled outside of bankruptcy court through means such as foreclosure, they do not breakdown bankruptcies by categories which differentiate between the types of legal and private procedures which took place.

¹¹ By contrast, American law offers either Chapter 7 or Chapter 11, and German law either Konkurs (liquidation) or Vergleich (reorganization). For a international survey of bankruptcy laws, accurate in general, but incomplete with respect to Japan, see The Economist (February 24, 1990: 77-78).

¹² This category actually is a narrower category, jiko hasan, or hasan cases applied for by the debtor. However, debtor applications for hasan now comprise the overwhelming majority of all corporate hasan cases, and those creditor applications that do occur usually follow a suspension of bank transactions, and thus are not recorded by Tokyo Shoko.

¹³ In this paper, at the risk of offending the purists among those schooled in the Western legal concept of bankruptcy, we opt to use the term "bankruptcy" in its most general usage, i.e., as inclusive of those business failures which are part of the Japanese "bankruptcy" statistics, and yet do not represent an application to one of the five bankruptcy courts. The verbal distinction between legal and private bankruptcy is an issue in Japanese as well. The common Japanese terms for business failure and bankruptcy, tosan and hasan, are used in a fashion which blurs the distinction: Tosan by itself is accurately translated as "business failure" but Tosan-ho refers to bankruptcy law; hasan has the strict legal meaning of a specific bankruptcy court, and yet is commonly used, to the dismay of Japanese bankruptcy scholars, to refer to general business failure. See the discussion in the explanatory memo on bankruptcy categories put out by the Tokyo Shoko (1991: 1-19).

¹⁴ The definition of the uchi-seiri category is given in the Tokyo Shoko memo, p. 19. The memo states that this category does not include one-sided concessions of one creditor or one group of creditors, which could perhaps partially explain why the most famous main bank bailouts, such as Mazda, or currently Itoman are not included in the bankruptcy statistics. The absolute number

of such bailouts, though small, is not insignificant: Suzuki and Wright, for example, recorded 34 bailouts of listed companies during the period 1974-78 (103). The main bank bearing of downside risk appears to be limited to corporate catastrophe, rather than part of a more general agreement which adjusts interest expenses to measures of corporate health. (Horiuchi et al, 1988).

¹⁵ Unlike the mechanisms of bankruptcy court, the suspension of bank transactions is a private sanction which does not rely on the authority of the law for its effectiveness, but is enforced among the banks through their common clearing house, which can impose a fine and even throw out member banks which do not follow the rule. For some English language discussion, see Ramseyer (1990) and Haley (1991).

¹⁶ For example, see Takagi (1984). Responsibility for the fatality should be probably be shared among the punishment and information aspects of the procedure. Although suspended firms could conceivably continue to operate on a cash basis through the establishment of a bank account in the name of another entity, a widely publicized inability to honor the second bill will mean that no future bills will be accepted by his suppliers, a terminal handicap in an environment where it is not uncommon for companies to be receiving more than six months credit on his suppliers' goods and services. (Takagi, 1988: 2-3). For evidence on the traditionally high reliance of Japanese companies on trade credit compared to Europe and the U.S., see Mayer (1990).

¹⁷ For an example of the frantic negotiations which proceed the coming due of a large quantity of bills for a distressed company, see Moritaka (1987: 52-56).

¹⁸ The principal exceptions being those bankruptcy applications which come after an organized private liquidation has been attempted and failed due to underestimated collective action problems among the creditors, or there arises a suspicion of fraudulent conveyance or other preferential activity to which the avoidance powers of bankruptcy court may apply. (Takagi and Nakamura: 38-40) The bankruptcy statistics of Tokyo Shoko do not record those bankruptcy applications which occurred after a failed organized private liquidation effort.

¹⁹ For the sake of conceptual clarity, numerous qualifications to the flow chart have been overlooked. In our opinion, the most important of these is that an organized private liquidation may very well have been considered prior to a bankruptcy court application and even begun prior to the suspension, particularly if the debtor has taken the initiative in calling a creditors meeting. However, while private liquidation may be initiated either before or after the suspension, and inevitably incur the suspension, an applicant to a liquidation based court will almost always occur before the suspension and not incur the suspension.

²⁰ Bulow and Shoven (1978) have proposed a model in which the decision to liquidate or to continue is taken by a coalition between the debtor and a key lender, often at the expense of other creditors. For follow-up work see White (1980, 1983).

²¹ For all dollar approximations of yen figures, we will using the rate 133.33 ¥ = \$1.

²² The categorization of Teikoku Data Bank's data differs slightly from that of Tokyo Shoko. Instead of the two categories of "Suspension of Bank Transactions," and "Internal Arrangement," Teikoku collects all bankruptcies which did not involve an application to bankruptcy court as Nini Seiri, roughly translatable as "Voluntary Arrangement." Teikoku officials confirmed that this

category consists mostly of suspended firms, and in particular, the firms in this category for the large firm sample of 1988-1990 had incurred the suspension of bank transactions.

²³ Our use of the term bankruptcy court is meant as a shorthand for the court services offered the debtor and creditors within the Japanese legal system under a particular bankruptcy code; we do not wish to imply that there are special bankruptcy courts with separate jurisdiction in Japan. Bankruptcy cases in Japan come under the exclusive jurisdiction of the District Court having jurisdiction over the location of the principal place of business, though a specified civil affairs section (depending on the district there can be more than one section for the different bankruptcy laws) of each district court will handle bankruptcy cases. As we will see later, there are some significant differences in judicial practice for bankruptcy cases between the districts. For a more explicit and detailed comparison of Japan's Corporate Reorganization and Bankruptcy Law with their U.S. equivalents, see Schumm (1988).

²⁴ The race to sue the bankrupt firm is similar to the well known "bank run" problem (for two different approaches see Diamond and Dybwig (1983) and Calomiris and Kahn (1991); for a survey see Calomiris and Gorton 1991). While the stay of unsecured claims can be justified in either liquidation or reorganization, generally the stay of the exercise of security rights must be justified in terms of protecting the value of the firm as a going concern in reorganization. (Baird, 1992: 1987, Ito: 16-18, 21, 24)

²⁵ As Easterbrook notes, the bankruptcy court separates decisions about claims to assets from decisions about the appropriate use of those assets. The former service of bankruptcy court can still be necessary even if the valuation problem is solved and the judge deals only with a "pot of cash." (416)

²⁶ These features of bankruptcy law are arguably aimed more specifically at conflicts of interest due to asymmetry of information between the debtor and its creditors. The basic conflict between the creditors and the debtor in the face of bankruptcy is often conceptualized as a creditor-shareholder conflict (see Stiglitz 1972; Bulow & Shoven 1978; White 1980, 1983; Golbe 1981). See Rose-Ackerman (1991) for work which explicitly allows for an autonomous role for management. See also White (1989) on this point.

²⁷ Two variants of asymmetric information models have been explored in detail by Webb (1987) and by Giammarino (1989). In Webb's model bargaining comes to an impasse because of asymmetric information about the value of the firm (on this point see also Roe, 1987; Wruck, 1990) In Giammarino's model the impasse arises because shareholders and bondholders have different beliefs about the settlement a court will impose.

²⁸ The two "games" of excessive risk taking and underinvestment were first analyzed by Jensen and Meckling (1976) and Myers (1977), respectively. Gertner & Scharfstein's model of financial distress (1991) offers a combined treatment of the two problems and find that: (a) the temptation to underinvest is strongest when bank debt is senior or when public debt is short-term and new public debt is subordinated; (b) the likelihood of excessive risk-taking behavior is higher when bank debt is junior, public debt is long-term and new public debt is senior. On the effects of seniority rules on the over and under-investment incentives see also Berkovitch & Kim (1990) and Nelson (1991).

²⁹ In practice, most of the few special liquidation petitions have been for the purpose of gaining the favorable interpretation granted by the Japanese tax authorities with regard to debt-writeoffs by creditors within the proceeding. In particular, large companies have commonly used it to write down their losses on the debt of subsidiary companies that they are dissolving. Since the preferential treatment of small claims is possible under tokubetsu seisan (Art. 448), when large concessions are made to outside creditors by the parent company, tax authorities are more inclined to consider the concession as losses rather than taxable gratuity expenses. (Tozai Tosan Jitsumu Kenkukai, 1989a: 266-268)

³⁰ Gilson et al. (1990) use what is arguably a better proxy: the number of creditors per dollar.

³¹ Recall further that Special Liquidation process is not well equipped to deal with highly leveraged cases where creditor panic could be a concern.

³² Numerous papers have taken the argument back to choice of optimal capital structure, for it has been suggested that firms with redeployable assets, e.g. those with higher liquidation value, are likely to take on more debt as well, foreseeing that liquidation will be a more palatable alternative in the case of default (Titman and Wessel 1988; Williamson 1988; Harris and Raviv 1990; Schleifer and Vishny 1991).

³³ That real estate cases should be handled out of reorganization court in the U.S. context as well is an argument of Molinaro (1991), who laments the increasing number of Chapter 11 filings by single-asset real estate companies and suggests that courts dismiss those cases for they represent an abuse of the process.

³⁴ See in particular the work of Koike (1988), Aoki (1988, 1990a, 1990b), and Hashimoto (1990).

³⁵ Further, the protection of employees is strengthened both in scope and status. The payment of their claims is assured by classifying them, mostly on grounds of social policy, as "common obligations" and therefore payable before other reorganization obligations. This is in stark contrast to say, hasan, where wages are not given as high a status as common obligations of the bankruptcy estate (Hiscock & Sono 1980, 774).

³⁶ The number of employees is commonly viewed by the courts as an indication of the firm's societal importance, which is one criterion for entrance into kaisha kosei.

³⁷ Though the deposit requirement is minimal in Special Liquidation, as discussed above, the services offered by the proceeding are too limited to make it an attractive alternative for the vast majority of firms.

³⁸ The dominance of out-of-court bankruptcy in Japan is undoubtedly related to a more general reliance in Japan on mechanisms of private settlement, a tendency much discussed in the field of Japanese legal scholarship. See in particular Haley (1978, 1980, 1991) and Ramseyer (1985) for the view that the Japanese courts are "slow, powerless, and expensive", and Ramseyer and Nakazato (1989) for the argument that in Japan parties are more likely to settle out of court because the outcome of court decisions can be predicted with relative ease.

³⁹ Most recently, arguments have made that "main banks" serve as a substitute for bankruptcy court in reorganizing firms (Sheard, 1991:34), and that the Japanese bank-firm relation is an important factor accounting for the low number of legal bankruptcy filings in Japan. (Frankel and Montgomery, 1991) In this paper, we have chosen to focus instead on a distinct class of private settlements - liquidations - which dominate the business failure statistics. .

⁴⁰ In what follows, we shall be referring to the "unorganized" pattern and self-help in the limited sense of individual and extra-legal attempts to pursue the satisfaction of claims. Of course, unsatisfied creditors in Japan may make individual use of Japanese civil execution law, but in principle creditors of the same rank who make use of the provisions of the law are treated equally (Ito: 16).

⁴¹ A reader has pointed out that the instigation of creditor panic by projected low distributions is a possible alternative explanation for this association.

⁴² This effective division of cases between the main bank and trade creditor is worth further documentation and analysis. In Bergloff's (1991) property rights approach to the comparison of financial systems, he suggests that the allocation of control may pass to "a reorganization specialist" (e.g., the "main bank") in those intermediate range of states between financial health and liquidation. The account below suggests that indeed a further distinction may be made between simply liquidated states and those states where the transfer of control to a "liquidation specialist" is worthwhile.

⁴³ In their discussion of why banks tend not to involve themselves in liquidation workouts, Takagi and Nakamura posit that banks, even when under-collateralized, do not want to get hands dirty by involving themselves in private liquidation workouts which can involve dealing with criminals, as discussed below, and are more susceptible to suspicious dealings more generally. An adage which they quote as appropriate is "Kunshi ayaukini chikayorazu (A wise man keeps out of harm's way)." (8-9)

⁴⁴ For an extremely detailed description of the procedures see Takagi and Nakamura: 70-132. Liquidation is not inevitable, particularly if the meeting is being called before the announcement of the bankruptcy. If the meeting occurs early enough, and is characterized by the cooperative presence of the company's management, one of the decisions of the first creditors' committee meeting is whether or not the company should continue as a going concern. (Ito and Tanase: 232-233)

⁴⁵ Although the pattern where the credit committee chairman assumed all responsibilities was the most common in the Ito and Tanase study, two other patterns of leadership they identified was the sharing of responsibility among a group of creditors, and the delegation of the responsibilities to a third party, such as a lawyer. (236, 239)

⁴⁶ For some recent journalistic analysis in Japan on organized crime and its range of white collar activity, see the Nihon Keizai Shimbun 7-part series. In a large scale example, the involvement of organized crime in the financial problems of Itoman has also been instructive; see "Mafia Shihon Shugi e no Keikoku," Toyo Keizai (1991).

⁴⁷ Additional terms include jiken-ya ("event-specialists"), sarubegi-ya (salvage specialists), pakuri-ya ("snap-up" specialists), or toritate-ya (bill-collectors) are also used.

⁴⁸ The following discussion of seiri-ya, unless otherwise noted, draws upon Miyazaki's informative and valuable article. The geographic concentration of seiri-ya in Osaka continues (Takagi, 1988: 137).

⁴⁹ That organized crime in Japan more generally fulfills some functions of lawyers in other societies has been previously suggested: it is not uncommon for parties with grievances, such as victims of traffic accidents, to hire jiken-ya, who are reimbursed proportionately, to obtain damage payments. (International Herald Tribune, August 30, 1991). In privately handled liquidation, a principal advantage of seiri-ya representation to that of lawyers are that lawyers demand an up-front payment, whereas seiri-ya are willing to forgo immediate compensation. (Takagi, 1988: 138-139). For a detailed discussion of the regulation of the legal services industry in Japan, see Ramseyer, 1986.

⁵⁰ Compare the debate in the United States surrounding recently created "vulture investment funds". According to one commentator the appearance of these funds has complicated the process of out-of court settlements (Rizzi, 1991, p. 44); see Africk (1991) for a more sympathetic view.

⁵¹ Certain similarities were also telling. Since the firm-specific assets of employee contracts will be equally lost in court-based versus private liquidation, we expected to see little difference in the number of employees, which was in fact the case.

⁵² That private liquidation is made more difficult by seiri-ya and will often leave no alternative but a hasan application is a common observation in how-to manuals on private workouts, see for example, Takagi and Nakamura: 27-28. As alluded to in 3.4.3, the above argument extends to private reorganizations as well; Shinjiro Takagi argues that applications for wagi are less in Tokyo because there are fewer seiri-ya operating in the Tokyo area (Takagi, 1990).

⁵³ Further evidence for the preference of legal liquidation in Osaka can be seen in the Bankruptcy (Hasan) columns of Table 6.

⁵⁴ Another hypothesis, with similar implications, is that the real estate industry differs from other industries in the nature of assets, which cannot be easily moved or taken away, thus reducing the need for the preservative measures of bankruptcy court.

⁵⁵ Aghion and Hermalin have asked, "what bankruptcy law is best, given that it must protect the corner grocery and the 'Fortune 500'?" (403). The Japanese system suggests that the policy question may be extended: What set of bankruptcy laws is best, given that it must try to protect the corner grocery and the 'Fortune 500,' while minimizing the incentive of both to abuse the protection?

⁵⁶ Roessler, at the time consul in Japan, was drawn to the French legal philosophy as a result of his opposition to Prussia and Otto von Bismark (see Henckel 1979).

⁵⁷ Under the German approach, bankruptcy is available to all persons both juristic and natural, as well as deceased estates. The influence of the German example is also visible in the division of the law into substantive provisions, procedural provisions and penal provisions (Nakano 1976; Henckel 1979). See also Matsuo (1971: 1-16).

⁵⁸ Previously debtors had also been deprived of numerous legal rights, such as the right to vote. These rights could only be recovered through a decree of restoration which was rendered when the remaining debts were fully paid or forgiven by the creditors (Takagi, 1984:3).

⁵⁹ Although the article calls only for an advance payment at the time of a creditor petition, the advance payment of costs has come to be required for debtor-petitioned bankruptcy as well. Article 140 of the Act which provides for the provisional payment out of the national treasury in debtor-petitioned bankruptcies is also ignored in practice. (Takagi, written communication; Matsuo, 1985a:13).

⁶⁰ Although creditors have the right to appoint superintendents to oversee the operations of the trustee (Article 170), in practice, the court discourages use of this article and it is rarely used (Takagi, 1988: 154).

⁶¹ For a sample of 90 firms that liquidated under Chapter 7 of the U.S. Bankruptcy Code in 1980, White (1983) found an average pay-off rate for unsecured creditors of 0.03%. But in another White (1984) sample the pay-off rates for unsecured creditors were 13%.

⁶² However, an important caveat concerning the capability of the trustee in hasan (as well as kaisha kosei) to avoid preferential acts is that Japanese court orders are not backed up by contempt. Lacking the power of contempt, the Japanese bankruptcy court may not enforce its decrees on its own motion, but must rely instead on cumbersome and, in practice, seldom invoked criminal sanctions. This weakness of enforcement constitutes a limitation of the Japanese legal system more generally (Haley 1980, 1982, 1991)) and is a particular problem in the exercise of avoidance in Japanese bankruptcy court (Takagi, 1984: 9).

⁶³ The 1929 English Corporate Law contained provisions for various sorts of liquidation ("winding up") of companies: i.e., court-led compulsory winding-up, winding-up under the supervision of the courts, and purely voluntary winding-up. (Aoyama, 1990b: 380)

⁶⁴ As procedures for voluntary liquidation are already governed under articles 417-430 of the Commercial Code, any case which enters special liquidation must have already fulfilled the requirements for voluntary liquidation procedures. These requirements include the board of directors decision to liquidation, submission of financial reports to the court and auditors, and the notification of creditors. In most cases, tokubetsu seisan applications are those which were planned prior for application for ordinary liquidation, and the application for special liquidation takes place concurrently with the decision to liquidate (Aoyama, 1990b: 381).

⁶⁵ In Tokyo, as of 1988, the deposit required ranged from 10-50 thousand yen (\$75-\$375) compared to a minimum of 700,000 yen (\$5,250) for hasan, while Osaka charges around 700,000 yen. (\$5,250) (Tozai Tosan Jitsumu Kenkyukai, 1989: 261-262)

⁶⁶ This feature of tokubetsu seisan (Art. 433) has been the subject of legal debate, since is somewhat in contradiction to the Article 456 which follows hasan in allowing secured creditors to freely exercise their security rights. See discussion in Aoyama, 1990b: 401.

⁶⁷ For a different view that kaisha seiri drew upon the concept of equity receivership in U.S. and U.K. law, see Takagi, 1983, 28-31.

⁶⁸ However, there is a limit to how much dissenting creditors can gain at the expense of the others. Because the corporate debtor is prohibited from making any payments not in accordance with the provisions of the plan, and creditors are prevented from taking execution proceedings while the case is pending (sometimes as long as seven years), recollection efforts will be severely hampered. (Takagi, 1984)

⁶⁹ Apparently, General MacArthur asked for modifications to the Japanese legal system, including the bankruptcy law, to allow America businesses to operate in Japan more easily (Takagi, 1984: 4)

⁷⁰ Only three-quarters of the secured claims need to approve when the plan provides only for the extension of maturity dates.

⁷¹ In White (1983) for a sample of 33 firms that reorganized under Chapter 11 in 1980, the average pay-off rates to unsecured creditors were 32%. In White (1984) the average pay-off rates were 16% in cash plus 18% (undiscounted) in installments payable over up to 6 years. In LoPucki & Whitford (1990) the average pay-off rates for a sample of 30 insolvent firms that filed for Chapter 11 between 1979-1988 were 28%. In the same study for a sample of 11 solvent debtors the average returns are 102% (undiscounted) and 81% (discounted).

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TABLE 1: FIRM BANKRUPTCY IN JAPAN BY BANKRUPTCY TYPE

Bankruptcy (Hasan)	Special Liquidation	Corporate Reorganization	Corporate Arrangement	Composition	Suspension of Bank Transactions	Internal Arrangement	TOTAL
1980 277 (1.55%)	-	41 (0.23%)	59 (0.33%)	261 (1.46%)	16,995 (95.03%)	251 (1.40%)	17,884
1981 281 (1.60%)	-	33 (0.19%)	52 (0.30%)	294 (1.67%)	16,714 (94.91%)	236 (1.34%)	17,610
1982 330 (1.93%)	-	26 (0.15%)	46 (0.27%)	292 (1.71%)	16,183 (94.52%)	245 (1.43%)	17,122
1983 513 (2.68%)	14 (0.07%)	23 (0.12%)	35 (0.18%)	282 (1.47%)	17,949 (93.70%)	339 (1.77%)	19,155
1984 637 (3.06%)	13 (0.06%)	33 (0.16%)	30 (0.14%)	325 (1.56%)	19,474 (93.44%)	329 (1.58%)	20,841
1985 717 (3.81%)	23 (0.12%)	21 (0.11%)	30 (0.16%)	336 (1.79%)	17,278 (91.85%)	407 (2.16%)	18,812
1986 856 (4.90%)	14 (0.08%)	35 (0.20%)	35 (0.20%)	385 (2.20%)	15,638 (89.48%)	513 (2.94%)	17,476
1987 696 (5.50%)	12 (0.09%)	13 (0.11%)	14 (0.11%)	228 (1.80%)	11,242 (88.83%)	450 (3.56%)	12,655
1988 536 (5.30%)	10 (0.10%)	5 (0.05%)	9 (0.09%)	119 (1.18%)	9,079 (89.70%)	364 (3.60%)	10,122
1989 381 (5.27%)	19 (0.26%)	7 (0.10%)	2 (0.10%)	60 (0.83%)	6,521 (90.14%)	244 (3.37%)	7,234
1990 388 (6.00%)	4 (0.06%)	6 (0.09%)	4 (0.06%)	46 (0.71%)	5,782 (89.39%)	238 (3.68%)	6,468

Source: Tokyo Shoko Research, which records bankruptcies of corporations with over 10 million yen in liabilities.
(Tokubetsu Seisan applications were not recorded as bankruptcies by Tokyo Shoko until 1983.)

FIGURE 1: THE PROCESS OF GOING BANKRUPT
AND THE BANKRUPTCY CATEGORIES

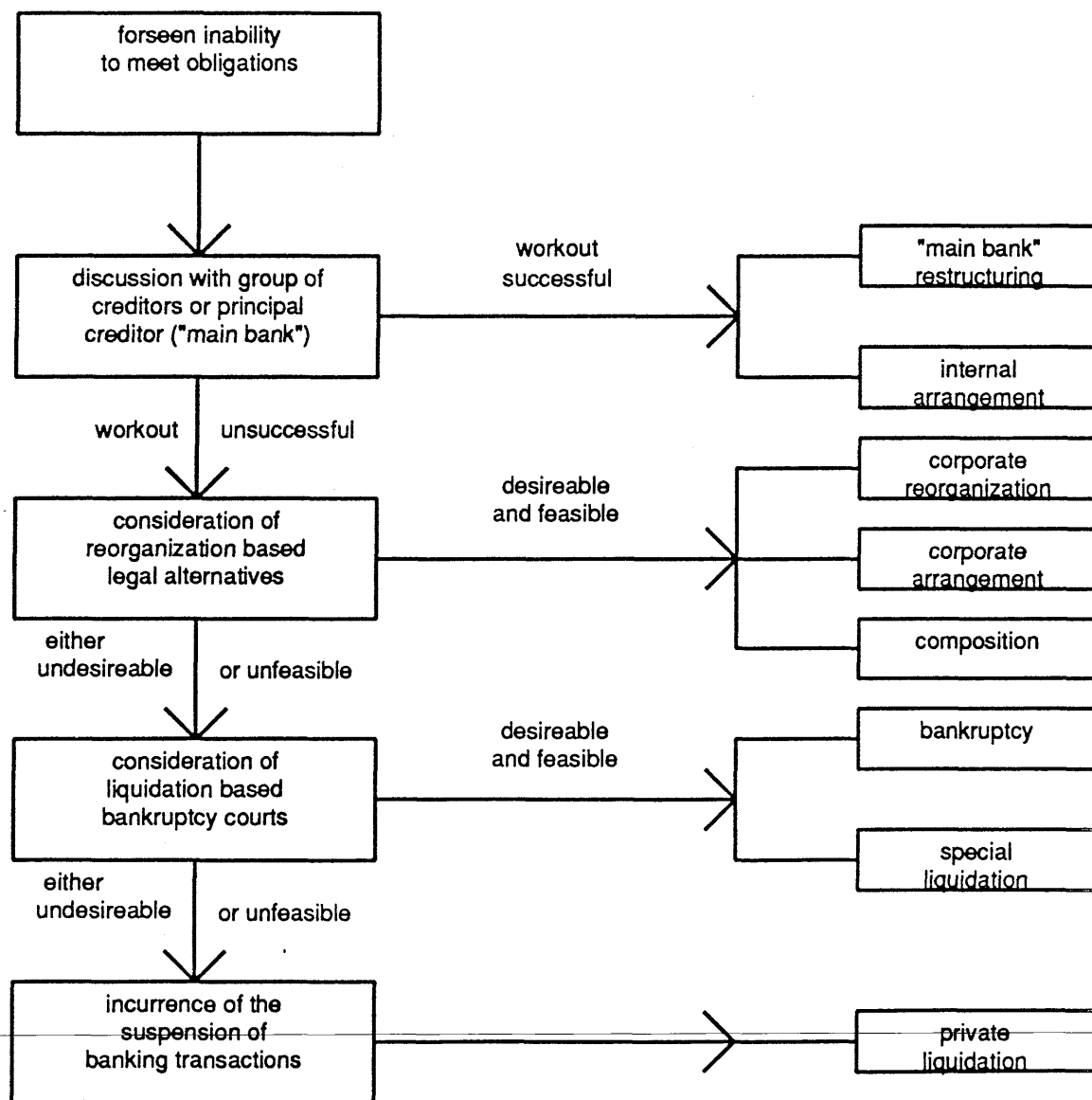


TABLE 2: THE SIZE DISTRIBUTION OF CORPORATE BANKRUPTCY IN JAPAN

Distribution by Paid-in Capital

	Unincorporated Enterprises	Corporations with Capital Under ¥1 Mill. [\$7500]	¥1-10 Mill. [\$7500-75,000]	¥10-50 Mill. [\$75-375,000]	¥50-100 Mill. [\$375-750,000]	Over ¥100 Mill. [\$750,000]
1985	5271 (28.0%)	553 (2.9%)	10,127 (53.8%)	2660 (14.1%)	162 (0.9%)	39 (0.2%)
1986	4611 (26.4%)	509 (2.9%)	9427 (53.9%)	2688 (15.4%)	173 (1.0%)	68 (0.4%)
1987	3832 (30.3%)	362 (2.8%)	6555 (51.8%)	1763 (13.9%)	104 (0.8%)	39 (0.3%)
1988	2980 (29.4%)	243 (2.4%)	5219 (51.6%)	1542 (15.2%)	100 (1.0%)	39 (0.4%)
1989	2119 (29.3%)	172 (2.4%)	3744 (51.8%)	1115 (15.4%)	71 (1.0%)	13 (0.2%)
1990	1637 (25.3%)	178 (2.8%)	3415 (52.8%)	1136 (17.6%)	75 (1.2%)	27 (0.4%)

Distribution by Liabilities

	Corporations with Liabilities ¥10-50 Mill. [\$75-375,000]	¥50-100 Mill. [\$375-750,000]	¥100-500 Mill. [\$.75-3.75 Mill.]	¥0.5-1 Bill. [\$3.75-7.5 Mill.]	Over ¥1 Bill. [\$7.5 Mill]
1985	8180 (43.5%)	4374 (23.3%)	5021 (26.7%)	708 (3.8%)	529 (2.8%)
1986	7051 (40.3%)	4301 (24.6%)	4799 (27.4%)	750 (4.3%)	575 (3.3%)
1987	5927 (46.8%)	2848 (22.5%)	3191 (25.2%)	402 (3.2%)	287 (2.3%)
1988	4799 (47.4%)	2283 (22.6%)	2441 (24.1%)	321 (3.2%)	278 (2.7%)
1989	3532 (48.8%)	1610 (22.3%)	1698 (23.5%)	228 (3.2%)	166 (2.3%)
1990	3189 (49.3%)	1295 (20.0%)	1514 (23.4%)	226 (3.5%)	244 (3.8%)

Source: Tokyo Shoko Research

TABLE 3: BANKRUPTCIES OVER ¥3 BILLION IN LIABILITIES, 1988-1990

	TOTAL	Private Liquidation	Bankruptcy (Hasan) (A)	Special Liquidation (B)	Liquidation Based Courts (A)+(B)	Corporate Reorga- nization (C)	Compo- sition (D)	Reorganization Based Courts (C)+(D)
No. of firms	185	103	43	4	47	9	26	35
% of which in real estate industry	27.0%	42%	9%	0%	8.5%	0%	15.4%	11.4%
% of which with head office in Osaka	12.7%	8%	23%	0%	21.2%	0%	23.1%	17.1%
Liabilities (¥ Billion) (Average)	12.8	10.4	12.1	12.5	12.1	19.5	20.5	20.2
Paid-In Capital (¥ Million) (Average)	117	47	84	860	150	397	128	197
Number of Employees (Average)	57	39	40	4	38	176	126	139

Source: Teikoku Data Bank.

TABLE 4: THE LIQUIDATION PROCEEDINGS COMPARED

	Special Liquidation	Bankruptcy	Chapter 7 (U.S.)
"Timely" Preservative Measures (Stay) Possible	No	Yes	Yes
Trustee Takes Control	No	Yes	Yes
Secured Claims Included	No	No	Yes
Court Has Powers of Avoidance	No	Yes	Yes
Voting Rules	$\geq 3/4$ of claims	No resolution required for general disposal and distribution; $\geq 1/2$ of claims for certain administrative matters.	No resolution required for general disposal and distribution

TABLE 5: THE REORGANIZATION PROCEEDINGS COMPARED

	Composition	Corporate Arrangement	Corporate Reorganization	Chapter 11 (U.S.)
"Timely" Preservative Measures (Stay) Possible	Yes	Yes	Yes	Yes
Trustee Takes Control	No	No	Yes	No
Super-priority Financing Possible	No	No	Yes	Yes
Employee Claims Given Priority	No	No	Yes	Yes
Secured Claims Included	No	No	Yes	Yes
Court Has Powers of Avoidance	No	No	Yes	Yes
Voting Rules	$\geq 3/4$ of claims	Unanimity required	$\geq 2/3$ of unsecured claims; $\geq 4/5$ secured claims.	$\geq 2/3$ of each claim class
Court Has Powers of "Cramdown"	No	No	Yes	Yes

TABLE 6: THE TOKYO-OSAKA DIFFERENCE IN BANKRUPTCY FILINGS

	<u>Bankruptcy (Hasan)</u>		<u>Special Liquidation</u>		<u>Composition</u>		<u>Corporate Arrangement</u>		<u>Corporate Reorganization</u>	
	<u>Tokyo</u>	<u>Osaka</u>	<u>Tokyo</u>	<u>Osaka</u>	<u>Tokyo</u>	<u>Osaka</u>	<u>Tokyo</u>	<u>Osaka</u>	<u>Tokyo</u>	<u>Osaka</u>
1980	236	489	11	9	14	93	9	12	14	3
1981	240	602	12	13	14	91	10	11	6	5
1982	305	777	10	15	21	72	6	11	10	1
1983	960	1653	11	5	17	65	4	8	4	2
1984	1462	2141	16	9	30	63	5	3	9	3
1985	1061	1589	18	9	17	60	3	4	8	4
1986	879	1391	23	5	23	60	4	4	5	2
1987	620	1139	33	5	11	25	2	2	0	1
1988	778	952	32	2	9	21	0	5	8	0
1989	824	706	28	9	2	3	0	0	7	0
TOTAL (1980-89)	7365	11,439	194	81	158	553	43	60	71	21

Source: Ikeda: 49.

**TABLE 7: STANDARDS FOR THE DEPOSIT REQUIREMENT
IN THE TOKYO REGION**

(Dollar values at rate ¥133.3=\$1)

<u>PROCEDURE</u>	<u>LIABILITIES</u>	<u>DEPOSIT</u>
BANKRUPTCY (HASAN) (Corporate)	Less than ¥50 million (\$375,000)	¥0.7 million yen (\$5,250)
	¥50-100million (\$375,000-750,000)	¥1 million yen (\$7,500)
	¥100-500million (\$750,000-3.75 million)	¥2 million yen (\$15,000)
	¥500million to ¥1 billion (\$3.75-\$7.5 million)	¥3 million yen (\$22,500)
	More than ¥1 billion (\$7.5 million)	¥4 million yen (\$30,000)
COMPOSITION	Less than ¥ 50 million (\$375,000)	¥2 million yen (\$15,000)
	¥50-100million (\$375,000-\$750,000)	¥3 million yen (\$22,500)
	¥100million to ¥1 billion (\$3.75-\$7.5 million)	¥4 million yen (\$30,000)
	More than ¥1 billion (\$7.5 million)	¥5 million yen (\$37,500)
CORPORATE ARRANGEMENT	Inclusive	¥5 million yen (\$37,500)
CORPORATE REORGANIZATION	Inclusive	Minimum of ¥10 million (\$75,000)

Source: Published by the Tokyo District Courts #8 and #20, the above information is reprinted in most Japanese manuals on bankruptcy, including Wagi (Tosai Tosan Jitsumu Kenkyukai: 26)

**TABLE 8: LENGTH OF PROCEEDINGS
IN BANKRUPTCY (HASAN) AND
CORPORATE REORGANIZATION**

BANKRUPTCY (HASAN)
(All cases concluded in 1989
with positive distributions)

From Application
to Conclusion

Less than 1 year	151 (5.8%)
1-2 years	598 (22.9%)
2-3 years	551 (21.1%)
3-5 years	685 (26.2%)
5-10 years	534 (20.4%)
More than 10 years	98 (3.7%)

CORPORATE REORGANIZATION
(All cases concluded in 1989)

From Application
to Commencement

Less than 1 month	0 (0.0%)
1-3 months	27 (44.2%)
3-6 months	23 (37.7%)
6-12 months	8 (13.1%)
1-2 years	2 (3.3%)
More than 2 years	1 (1.6%)

From Commencement
to Approval of the Plan

Less than 1 year	4 (6.5%)
1-2 years	34 (55.7%)
2-3 years	12 (19.6%)
3-5 years	9 (14.8%)
More than 5 years	2 (3.3%)

From Approval of the Plan
to Conclusion

Less than 1 year	1 (1.6%)
1-2 years	1 (1.6%)
2-3 years	11 (18.0%)
3-5 years	3 (4.9%)
More than 5 years	45 (73.8%)

Source: Annual Report of Judicial Statistics (1989).

TABLE 9: ORGANIZED PRIVATE LIQUIDATION AS A SUBSTITUTE FOR BANKRUPTCY COURT (HASAN)

Procedures of Bankruptcy (Hasan)	Substitute Mechanisms of Organized Private Liquidation	Degree of Substitution
Preservative Measures	Voluntary agreement among parties to restrain from self-help measures is solicited.	Low
Stay Provisions:		
1. Ordinary Claims	Voluntary agreement among creditors to forbear from execution; Lead creditor can arrange a buy-out of recalcitrant creditors; Property rights in movables may be transferred from debtor to creditors committee.	Low
2. Security Rights	(are not affected in either setting)	
Control of the Estate	Control rights are transferred to the creditors committee chairman; though if the debtor is trusted and cooperative, she or her representative may be permitted manage the liquidation instead.	Medium
Examination of Credit Claims and Distributions	The Chairman handles the filing of claims any disputes arising in the process. The reputation of the Chairman is a bond for the fairness of the distribution.	Medium
Methods of Recovery and Realization	Persuasion of debtors of the bankrupt to pay; Private asset sales with timing at the discretion of the chairman and no court consent required. Chairman further can assist in the informal liquidation of secured assets, negotiating with secured creditors for the benefit of the estate.	High
Voting Rules	None.	Low
Availability of Discovery	The chairman reports to the creditors committee on the estate but can get information from debtor only if she cooperates voluntarily and faithfully.	Medium
Avoidance	Creditors who grabbed assets in fear of a generalized run may be encouraged by the institution of private settlement proceedings to return assets to the estate; Creditors who grabbed assets with fraudulent intent are beyond the reach of private liquidation.	Low

TABLE 10: DIFFERING INTERPRETATIONS OF THE "FIXER"

"Fixer" Services	A Positive Interpretation	A Skeptical Interpretation
Asserting leadership at the first creditors meeting	Helps to achieve coordination among creditors; makes communication with the debtor easier; can help alleviate collective action problems.	Excessive influence obtained through shrewd diplomacy.
Buying up distressed claims	Simplifies the creditor structure by consolidating claims; Helps alleviate collective action problems.	Can create blocking minority with the power to delay a settlement; presentation of distressed claims to the debtor may be used for intimidation purposes.
Occupation of the company headquarters at the request of the debtor	Serves to relieve the contentious relations between debtor and creditors by protecting the debtors physical integrity.	Equivalent to taking the debtor hostage.
Occupation of the company headquarters at the request of creditors	Serves to relieve the contentious relations between debtor and creditors by keeping managerial misconduct in check	Illegitimate takeover of the company books, stamp, and other control rights.
Retrieval of debts	Adds value to the estate	Methods used during collection may impose net costs on society; "Fixer" may be in a position to extract monopoly price for collection services.
Liquidation sale to related companies	Cost and time of locating a purchaser are minimized	Where assets are sold below market value, constitutes a drain from the estate by the "fixer."
Intimidating creditors	Convincing hold outs to go along with proposed settlement.	Coercion to obtain approval for unfair distribution.
Creation of new credit claims	Compensation for services rendered.	Reduces the value of other claims; complicates the settlement process.
Creation of leasing right on land	Intended to prevent foreclosure on collateral by overaggressive secured creditors; possibly compensation or security for emergency credit granted.	Represents means by which to harass lenders, extract concessions from secured creditors, and reduce the value of their claims.
Filing for Wagi	Provides debtor with a breathing spell and the parties with the opportunity to work things out in an amicable fashion.	The protection afforded by the court may be used to "clean up" the estate.