

BANKS, BONDS AND RISK: THE MYCAL BANKRUPTCY AND ITS REPERCUSSIONS FOR THE JAPANESE BOND MARKET*

I. INTRODUCTION

The recent bankruptcy of Japan's retail giant Mycal has brought great focus on numerous weaknesses in Japan's financial system. The assessment by Japanese banks of the amounts and classifications of bad debt on their books has been substantially underestimated.¹ As a

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1. In a recent visit to Tokyo, Kenneth Dam, the U.S. Deputy Treasury Secretary, said that Japan's bad debt problem (the amount of non-performing loans carried by Japanese banks), measured as a percentage of gross domestic product, could be four to six times as large as the U.S. savings and loan industry's insolvency crisis of the late 1980s. See James Brooke, *U.S. Urges Japan To Act Quickly On Bad Loans*, INT'L HERALD TRIBUNE, Dec. 11, 2001, at 1. Although the problem is getting worse, it is hardly new; articles from the first half of the 1990s read as if they were written a week ago, only the names and dates change. The bad loan burden was estimated to be as high as ¥80 trillion (\$667 billion) in 1995, and even the Ministry of Finance admitted it was probably at least as high as ¥40 trillion (\$333 billion). *Japanese Banking: Less Dishonest*, ECONOMIST, June 10, 1995, at 68, 68; see *Japan's Monetary Implosion*, ECONOMIST, Oct. 31, 1992, at 75, 75-76 (estimating non-performing loan burden on Japanese banks as high as ¥60 trillion (\$500 billion) and predicting that Japanese banks' reluctance to sustain losses would prevent them from writing off their domestic bad debts for years, perhaps even for a decade).

The origin of many of these bad loans lies in the collapse of property values that occurred in the wake of the bursting of Japan's bubble economy in the early 1990s. See generally CHRISTOPHER WOOD, *THE BUBBLE ECONOMY: JAPAN'S EXTRAORDINARY SPECULATIVE BOOM OF THE '80S AND THE DRAMATIC BUST OF THE '90S 1-78* (1992). Wood predicts a banking crisis caused by an avalanche of bad debts, most of them property related. *Id.* at 14. The bad loan crisis is complex, and Wood's book expertly explains its numerous causes as well as the origins and consequences of the bubble itself. Dependent upon property as collateral supporting the credit they extended during the speculative frenzy of the bubble, Japanese banks and non-banks (leasing companies, real estate or consumer finance companies, etc.) found themselves saddled with huge non-performing loan loads as a result. But the banks were unable to begin writing off loans, for that would entail selling the real property collateral supporting the loans at depressed prices, which would further pull down land values and create more non-performing loans. Banks therefore chose instead to wait for prices to recover; they never have,

result, the true financial status of some of the largest borrowers from Japan's banks has been obscured, and companies that are either teetering on the edge of bankruptcy or that should have been pushed over the edge long ago are still being propped up.² This unwillingness by banks to let their worst debtors fail exacerbates the shock on Japan's financial markets when large companies like Mycal finally do collapse. In particular, Mycal's bankruptcy has damaged confidence in Japan's corporate debt market. Many investors feel they are being misled about the true financial status of companies that issue debt, and that corporate bond trustees and banks are not protecting their interests.³ Over 20,000 individual investors will only recover a fraction of the face value of their Mycal bonds, which were rated investment grade just months before the retailer filed for court protection.⁴

The Mycal bankruptcy has become a symbol of the problem, if not the most prominent event in Japan that has brought attention to

and with the value of the stock market collapsing as well, the bad loan problem only continues to worsen. See *Japanese Banks: Bad-debt Troubles*, ECONOMIST, Sept. 14, 1991, at 97, 97-98 (describing the dependence of Japan's banks on property as collateral for loans, why that caused banks not to take steps to reduce their bad debts, and how non-banks were used as channels for investment in real estate during the bubble economy in order to circumvent more stringent restrictions preventing such investment by the banks themselves); *Japan's Non-banks: What a Mess*, ECONOMIST, Oct. 26, 1991, at 96, 98 (explaining the extent of the non-bank bad debt problem and its huge impact on the banks that back them); WOOD, *supra*, at 38-44 (detailing the extent of the non-bank problem, and the lack of action taken by Japanese banks against their bad debts).

2. *Dead, or just resting?*, ECONOMIST, July 14, 2001, at 70, 70. Few of the big, economically battered borrowers from Japanese banks have been classified as either bankrupt or in danger of bankruptcy (the serious "bad debt" categories), and have instead been classified as *yōu chūui saki*, or "in need of monitoring." Under official guidelines, Japanese banks currently carry about ¥13 trillion (\$108 billion) of bad debt, but when weak borrowers that have been grouped in the "in need of monitoring" category are also included, the bad debt burden weighing on Japan's banks is as high ¥150 trillion (\$1.25 trillion). *Id.* One of the reasons for the underestimation of the bad debt problem is the difference in reserves that Japanese banks must set aside for the two different categories of loans: seventy percent of the value of the loan for loans "in danger of bankruptcy," as opposed to only five percent for loans "in need of monitoring." *Id.* Reclassifying these weak borrowers could push the capital ratios of many Japanese banks below the eight percent minimum required by the Bank for International Settlements. See *Banks precariously close to sinking into red*, NIKKEI WKLY., Oct. 15, 2001, at 1; *Banks' bad-loan bumbling*, *supra* note 1, at 19. Mycal was classified as "in need of monitoring" by Dai-Ichi Kangyo Bank, its main lender, until the day it filed for bankruptcy.

3. See Atsushi Suemura, *Deforuto De Rotei Shita Shasai Shijyō No Mijyukusa [The Immaturity of the Japanese Corporate Debt Market Exposed by Defaults]*, 53 KIGYŌ KAIKEI 82, 82 (2001); Natsumi Tsukamoto, *Mycal failure blindsides bond market*, NIKKEI WKLY., Oct. 8, 2001, at 12.

4. In mid-September it was estimated that these investors would suffer an average loss of ¥4 million (over \$33,000) each. Yoichi Takita, *Drastic steps needed now in cleanup of bad loans*, NIKKEI WKLY., Sept. 24, 2001, at 7.

it. This note will focus primarily on the Mycal bankruptcy in the context of the Japanese corporate debt market, and on why the impact of the retailer's failure was as extensive as it was. Part II summarizes the factual background of the Mycal bankruptcy. Part III details the bankruptcy's impact on Mycal's bondholders, as well as its overall effect on the Japanese corporate bond market. Part IV focuses on the dramatic changes that have taken place in the Japanese corporate bond market since World War II, on its early 1990s reform, and on why Mycal's impact ten years later was so dramatic. Part V concludes with some general observations about Mycal, the corporate bond market, and Japan's economic crisis in general.

II. THE MYCAL BANKRUPTCY: FACTUAL BACKGROUND

A. General

On September 14, 2001, Mycal, Japan's fourth largest retailer and supermarket giant, shocked the country by announcing that it was filing for bankruptcy under the Civil Rehabilitation Law (*Minji Saiseihō*).⁵ The immediate reason for Mycal declaring bankruptcy was that it was unable to come up with the ¥40 billion (\$333 million) needed to pay creditors by a September 17 deadline.⁶ Mycal's stock price had been steadily plunging, which made it difficult to borrow additional funds, even from its main lender, the Dai-Ichi Kangyo Bank (DKB).⁷ At the time Mycal filed for bankruptcy, it owed DKB

5. *Maikaru Hōteki Seiri He, Fusai 1 Chō En Chō, Shu Ryoku Kō Shien Uchikiri* [Mycal Declares Bankruptcy, Main Bank Cuts off Support], NIHON KEIZAI SHIMBUN, Sept. 14, 2001 (evening ed.), at 1 (providing a brief history of Mycal). Four retailers merged in 1963 to form Mycal; by the time it had filed for reorganization, Mycal had 15,900 full-time employees and 36,500 part-time employees. *Id.*; *Maikaru Saiseihō Shinsei, Fusai 1 Chō 7400 Oku En* [Mycal Files for Civil Rehabilitation, 1.74 Trillion Yen in Bad Debt], NIHON KEIZAI SHIMBUN, Sept. 15, 2001, at 1 [hereinafter *Mycal Files for Civil Rehabilitation*]; see also *Minji saiseihō* [Civil rehabilitation law], Law No. 225 of 1999.

6. *Saiken Shudōken, Ginkō to Antō* [Hidden Fight with Bank over Restructuring Leadership], NIHON KEIZAI SHIMBUN, Sept. 15, 2001, at 3 [hereinafter *Hidden Fight with Bank*].

7. *Mycal goes belly-up after banks refuse to extend further support*, NIKKEI WKLY., Sept. 17, 2001, at 1, 21 [hereinafter *Mycal goes belly-up*]. On September 12, 2001, the company's stock price sank as low ¥62 (\$0.52) per share. *Id.*; see *infra* note 50 for source with Mycal stock price and credit rating graph. For a description of the Japanese main bank system, which refers to a system of corporate financing and governance in which the main bank is a borrower's primary lender, a principal shareholder, and assumes a vital monitoring and, if necessary, restructuring role towards the borrower, see generally THE JAPANESE MAIN BANK SYSTEM: ITS RELEVANCE FOR DEVELOPING AND TRANSFORMING ECONOMIES (Masahiko Aoki & Hugh Patrick eds., 1994); Paul Sheard, *The Main Bank System and Corporate Monitoring in Japan*, 11 J. ECON. BEHAV. & ORG. 399 (1989).

¥162 billion (nearly \$1.35 billion) in outstanding loans, almost exactly double DKB's exposure to Mycal in late February 2001.⁸ Mycal's outstanding loans to the entire Mizuho Financial Group (DKB, Fuji Bank, the Industrial Bank of Japan, and Yasuda Trust) totaled ¥316 billion (over \$2.6 billion), ¥150 billion of which was not covered by either collateral or loss reserves.⁹ In the days before Mycal collapsed, smaller lenders realized how precarious the retailer's position was and began calling in their loans. DKB was forced to either pay them off or lose its entire investment in the supermarket giant.¹⁰ In all, Mycal was in debt to the tune of ¥1.74 trillion (\$14.5 billion), an amount slightly greater than its consolidated sales for the entire fiscal year 2000 ended February, 2001 (¥1.72 trillion, \$14.3 billion), and making it Japan's fifth largest post-war bankruptcy.¹¹

8. *Dokumento, Maikaru Hatan #2: Ginkō, Kyōchō Ni Genkai* [Mycal Bankruptcy Feature #2: Limits to Bank Cooperation], NIHON KEIZAI SHIMBUN, Sept. 16, 2001, at 3. In the seven-month period between February and September, 2001, DKB loaned an additional ¥83.6 billion (\$697 million) to Mycal. *Id.*

9. *Dokumento, Maikaru Hatan #2: Ginkō, Kyōchō Ni Genkai* [Mycal Bankruptcy Feature #2: Limits to Bank Cooperation], NIHON KEIZAI SHIMBUN, Sept. 16, 2001, at 3; *Mizuho, Saishū Akaji No Kōsan* [Mizuho, Final Projections in the Red], NIHON KEIZAI SHIMBUN, Sept. 15, 2001, at 4.

10. *Mycal's decision to cave in displeases main lender*, NIKKEI WKLY., Sept. 24, 2001, at 13. Between the end of December 2000 and the end of August 2001, The Mizuho Financial Group's outstanding loans to Mycal increased from just under ¥200 billion (\$1.67 billion) to over ¥300 billion (\$2.5 billion), while loans to Mycal from other financial institutions dropped over ¥125 billion to under ¥240 billion (\$2 billion). *Dokumento, Maikaru Hatan #2: Ginkō, Kyōchō Ni Genkai* [Mycal Bankruptcy Feature #2: Limits to Bank Cooperation], NIHON KEIZAI SHIMBUN, Sept. 16, 2001, at 3. In February 2001, Sanwa Bank, Norin Chūkin Bank, Shinsei Bank, and Sumitomo Trust Bank all turned down DKB's requests for their participation in a syndicate loan to keep Mycal afloat. *Id.* In August 2001, DKB extended ¥50 billion (\$417 million) in additional loans to Mycal in a last-ditch effort to keep the retailer alive while it discussed tying up with American retail giant Wal-Mart. *Id.*

For a helpful discussion of loan syndication in the Japanese main bank system and how it has evolved since World War II, see Toshihiro Horiuchi, *The Effect of Firm Status on Banking Relationships and Loan Syndication*, in THE JAPANESE MAIN BANK SYSTEM 258, 275-87 (Masahiko Aoki & Hugh Patrick eds., 1994). Since 1985, bank syndication in Japan has taken the form of an "implicit" or "de facto" syndication, with no formal syndicate, manager bank, or fee structure, while still maintaining a hierarchical ranking headed by the main bank in a monitoring role that induces other lenders to participate. *Id.* at 285. Just how weak Japanese main banks have become is strikingly demonstrated by DKB's inability to effectuate the February syndicate loan, as well as in the dispersal of monitoring and information gathering functions to the smaller banks that refused to participate.

11. *Mycal goes belly-up*, *supra* note 7, at 1. The two largest of the top five Japanese bankruptcies were life insurance companies Kyoei Seimei Hoken (total debt ¥4.53 trillion, or \$37.75 billion) and Chiyoda Seimei Hoken (¥2.94 trillion, or \$24.5 billion), both of which went under in October, 2000. *Hidden Fight with Bank*, *supra* note 6, at 3. The fourth largest bankruptcy was another retailer, Sogo Group, which collapsed in July 2000, holding over ¥1.87 trillion (\$15.6 billion) of debt. *Id.*

B. Mycal's Expansion and Decline

Mycal expanded and diversified enormously through Japan's infamous asset-inflated bubble economy of the late 1980s, adding fitness centers and movie theater complexes to the operation of 215 stores across Japan.¹² These large investments resulted in spiraling interest-bearing debt, however, and with the bursting of Japan's economic bubble, the collapse of share prices and real estate values, and Japan's extended economic downturn throughout the 1990s, Mycal's excessive levels of facilities and debt became a heavy burden.¹³ Between 1991 and 2000, Mycal's floor space in its oversized stores increased by sixty-one percent, but its total sales increased by only two percent, reflecting a huge decline in efficiency.¹⁴ In January 2001, Mycal announced a three-year restructuring plan that included closing fifty unprofitable stores and eliminating 2,700 jobs, and in February it promised to trim its interest-bearing debt from ¥1.15 trillion (\$9.58 billion) to ¥910 billion (\$7.58 billion) by the end of August 2001.¹⁵ The beginning of the end came when Mycal was unable to securitize property and raise ¥120 billion (\$1 billion) as a result of a downgrade of the company's bond rating in June, 2001.¹⁶ Mycal was

12. *Mycal goes belly-up*, *supra* note 7, at 1. Mycal's short-lived president, Kozo Yamashita, also wrote an interesting article on how the company's expansion reflected the philosophy of its then-president, Toshio Kobayashi, and how this expansionary policy was responsible for Mycal's demise. See Kozo Yamashita, *Zaii Nishūkan, Yarubeki Koto Ha Yatta [During My Two Week Tenure, I Did All I Should Have]*, NIKKEI BUS., Oct. 15, 2001, at 139–42. Yamashita also criticizes past management's practice of keeping unprofitable stores open (so long as other profitable stores balanced out the losses) as a way of giving back to the community, as well as the decision to diversify into areas in which Mycal had little experience, such as the retail of sporting goods and electronics and the operation of hotels, in relation to the construction of "Mycal town" malls. *Id.* Such unrelated diversification strategies have frequently been criticized. See, e.g., W. CARL KESTER, JAPANESE TAKEOVERS: THE GLOBAL CONTEST FOR CORPORATE CONTROL 273 (1991) ("[M]any of the new businesses being pursued have only the loosest of connections with the investing firm's organizational capabilities."); Michael Bradley et al., *Challenges to Corporate Governance: The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROB. 9, 65 (1999) (The system of corporate cross-shareholding in Japan "may lead managers to undertake excessive investments in capacity and may create the tendency for . . . uneconomical diversification.").

13. *Mycal goes belly-up*, *supra* note 7, at 1; *Investors with Mycal bonds worried about recovery ratio*, NIKKEI WKLY., Sept. 24, 2001, at 14.

14. *Tachisukumu Kigyō, #4: Maikaru Fujiyō Ni Ashikase [Petrieved Business, Part 4: Obstacle to Mycal's Rise]*, NIHON KEIZAI SHIMBUN, Nov. 24, 2001, at 1. The Japanese retail industry suffers from serious over-capacity; as much as thirty percent of the total number of large-scale retail outlets in Japan are excess facilities and unneeded. *Id.*

15. *Mycal goes belly-up*, *supra* note 7, at 21.

16. *Id.*

forced to announce in late August that it had no choice but to delay its debt-reduction plan, and confidence and its financial support quickly evaporated.¹⁷

C. Structuring Bankruptcy and Changing Leadership

On the same day Mycal filed for bankruptcy, it announced that it had voted to dismiss its president, Osamu Shikata, and to replace him with a director, Kozo Yamashita, who favored filing for protection under the new Civil Rehabilitation Law.¹⁸ It soon became apparent,

17. *Id.*

18. *Id.* at 1; *Mycal Files for Civil Rehabilitation*, *supra* note 5, at 1.

Japan has five types of insolvency proceedings. Three of these proceedings are procedures for reorganization and rehabilitation of the debtor. The Corporate Reorganization Law [*Kaisha kōseihō*], Law No. 172 of 1952, is a separate law categorized under Japan's Code of Civil Procedure [*Minji soshōhō*] and modeled on Chapter X of the U.S. Bankruptcy Act of 1898. *See* Bankruptcy Act of 1898, ch. 10, 30 Stat. 544 (repealed 1978). Company Arrangement [*Kaisha seiri*], Law No. 72 of 1938, is a corporate work-out procedure under Articles 381–403 of the Commercial Code [*Shōhō*]. SHŌHŌ, arts. 381–403. Finally, the Civil Rehabilitation Law, Law No. 225 of 1999, also categorized under the Code of Civil Procedure, replaced the Composition Law Proceedings [*Wagihō*], Law No. 72 of 1922 (repealed 2000), in April 2000, and is intended for small-to medium-sized debtors. In practice, the Corporate Reorganization Law and the Civil Rehabilitation Law are the most common reorganization proceedings, and Company Arrangement is seldom used.

There are also two terminal proceedings that end in the liquidation and dissolution of the debtor (for legal entities). These are Special Liquidation [*Tokubetsu seisan*] and the Bankruptcy Law [*Hasanhō*]. Special Liquidation is a procedure provided in Articles 431–456 of the Commercial Code and used to dissolve companies that have an excess of debts over assets and therefore cannot complete a normal dissolution. Tokubetsu seisan [Special liquidation law], Law No. 72 of 1938; SHŌHŌ, arts. 431–56. The Bankruptcy Law is categorized under the Code of Civil Procedure and is the proceeding of last resort for debtors, whether as an original proceeding or as a clean up for the failure of a corporate reorganization, company arrangement, civil rehabilitation or special liquidation. Hasanhō [Bankruptcy law], Law No. 71 of 1922. It may be utilized by any entity, including individuals. *See* Hideyuki Sakai & C. Christian Jacobson, *Japan*, in 2 COLLIER INTERNATIONAL BUSINESS INSOLVENCY GUIDE § 29.08(2)(a) (Richard F. Broude et al. eds., 2001).

A surprising number of Japanese reorganizations, however, take place outside of the legal system, thanks to the role of main banks in assisting borrowers in times of financial crisis, and because of the heavy involvement of Japanese organized crime in bankruptcy and debt collection. *See* Curtis J. Milhaupt & Mark D. West, *The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime*, 67 U. CHI. L. REV. 41, 54–55, 66–69 (2000). Among other categories of gangsters, *seiriya* (fixers), *toritateya* (debt collectors), and *yonigeya* (one who helps another flee in the night) play extensive roles on behalf of both debtors and creditors in insolvencies. *Id.* at 67–68. Japan's scarcity of lawyers has led to the development of numerous organized crime-related specialists, who view themselves as *urashakai no bengoshi*, or "lawyers for the dark side of society." *Id.* at 69. On the pivotal role of Japanese main banks in restructuring troubled borrowers, see generally Paul Sheard, *Main Banks and the Governance of Financial Distress*, in THE MAIN BANK SYSTEM 188 (Masahiko Aoki & Hugh Patrick eds., 1994); Sheard, *supra* note 7, at 407–11. "[T]ogether with the system of stable interlocking shareholdings, . . . the main bank performs a role that closely parallels in its effect the external

though, that the change in leadership was not simply a symbolic gesture of assumption of responsibility, but rather reflected deep divisions between Mycal's management and its main lender, DKB, as to how to resurrect the moribund company. DKB wanted Mycal to file under the Corporate Reorganization Law (*Kaisha Kōseihō*) in exchange for the bank's support through the reorganization proceedings.¹⁹ Former president Shikata was willing to follow DKB's wishes, and the plan was for DKB to provide temporary financing to Mycal after it filed for bankruptcy in order to keep its stores open, to facilitate a takeover by another Japanese retailer, and to avoid negative effects on its trade creditors.²⁰ But Mycal's Board of Directors threw a wrench into the works by instead dismissing Shikata as president, selecting Yamashita to replace him, and filing under the Civil Rehabilitation Law at his suggestion.²¹

Whereas the Civil Rehabilitation Law allows a debtor's management team to remain in place,²² it is customary practice in Japan

takeover market: in particular in bringing about the displacement of ineffectual management and the reorganization of corporate assets to improve efficiency." *Id.* at 409.

19. *Hidden Fight With Bank*, *supra* note 6, at 3. DKB reportedly wanted Mycal to file under the Corporate Reorganization Law because the law allows debt that is held by creditors to be reduced at the same percentage across the board, thereby easing the loss incurred by the main bank in comparison to other creditors. *Id.* It is more likely, however, that Corporate Reorganization proceedings will be *less* advantageous for DKB, Mycal's largest secured creditor, because they prohibit the foreclosure of any liens once a protective order has been given, like the effect of an automatic stay under U.S. Bankruptcy Code Section 362. 11 U.S.C. § 362 (2000); see *Kaisha kōseihō* [Corporate reorganization law], Law No. 172 of 1952, arts. 39, 123, 124. The Corporate Reorganization Law has no provision comparable to the right [*betsujyōken*] given secured creditors under either the Civil Rehabilitation Law, art. 53, or the Bankruptcy Law, arts. 92–97, to foreclose their liens. DKB's reasoning behind its insistence on the use of the Corporate Reorganization Law, therefore, is somewhat of a mystery and may perhaps have been more motivated by politics than economics. Interview with Hideyuki Sakai, Founding Partner of The Law Offices of Hideyuki Sakai, in Tokyo, Japan (Dec. 14, 2001) (suggesting that the lawyer closest to Shikata was more experienced with the Corporate Reorganization law).

20. *Hidden Fight With Bank*, *supra* note 6, at 3; see also Yamashita, *supra* note 12, at 142 (claiming that Shikata was prepared to file under the Corporate Reorganization law as a precondition to support from rival Japanese retailer Aeon). Because over a third of Mycal's stores were in direct competition with Aeon's, however, this strategy would entail closures and layoffs. *Id.* Yamashita, on the other hand, had been involved in takeover negotiations with Wal-Mart since March 2001, and because the foreign retailer had no foothold in Japan, he assumed it would be more likely to take Mycal over without painful restructuring. This was probably an over-optimistic assessment of Wal-Mart's intentions.

21. *Hidden Fight With Bank*, *supra* note 6, at 3.

22. *Minji saiseihō* [Civil rehabilitation law], Law No. 225 of 1999, art. 38, para. 1 ("The debtor has the right to carry on his duties, manage finances, and dispose of assets even after the beginning of Civil Rehabilitation proceedings."). Article 38, paragraph 1 of the Civil Rehabilitation Law approximates the rights, powers, and duties of a debtor in possession under Chapter 11 of the U.S. Bankruptcy Code. See 11 U.S.C. § 1107(a) (2000).

for a company's management to resign upon filing under the Corporate Reorganization Law.²³ Mr. Shikata would later say that his replacement was a “*coup d'état* by part of current management to maintain control after bankruptcy.”²⁴ The dramatic boardroom fireworks, however, reflected not just a power struggle, but a deepening trend in Japanese finance and a deep divide between new President Yamashita and DKB. Yamashita had been instrumental in trying to distance Mycal from DKB's control in the years leading up to the bankruptcy; since 1996, Mycal raised over ¥260 billion (\$2.17 billion) through twenty-seven different domestic corporate bond issuances.²⁵

The coup, however, did not last long. Yamashita resigned as president on September 28, and was replaced by Kazuo Urano, another of Mycal's directors, in order to repair relations with Mycal's banks (in particular DKB) and trading partners.²⁶ By filing under the Civil Rehabilitation Law, Yamashita had quickly sought to restructure Mycal without the help of its main bank, but two weeks later, unable to secure any substantial financing, he instead found himself isolated, having burned Mycal's bridges. Without the backing of a main bank, so important to most Japanese businesses, many trade

23. *Hidden Fight With Bank*, *supra* note 6, at 3. Although nothing in Japan's Corporate Reorganization law requires management's resignation, the trustee [*kanzainin*] is automatically appointed and takes over all rights regarding the management of the company and the disposition of its assets, *see* *Kaisha kōseiho* [Corporate reorganization law], Law No. 172 of 1952, art. 53, effectively emasculating management, so they typically resign anyway.

24. *Hidden Fight With Bank*, *supra* note 6, at 3.

25. *Mycal's decision to cave in displeases main lender*, *supra* note 10, at 13; *Yameru Kinyu #3: Chijimu Ginkō* [Sickly Finances, Part 3: Shrinking Banks], *NIHON KEIZAI SHIMBUN*, Sept. 18, 2001, at 7 (“Although the financial strategy of Japanese businesses is leaning increasingly towards the capital markets and away from bank financing, struggling companies that are having trouble obtaining financing on the capital markets find themselves still beholden to their main lenders.”). This quote from the article accurately depicts Mycal's situation. The picture is, however, more complicated. The trustee [*shasai kanri gaisha*] for Mycal's corporate bonds was DKB, which raises questions concerning conflict of interests. *See* Suemura, *supra* note 3, at 82; *see also infra* Part IV.C.

26. *Konran Tsuzuku Maikaru Saiken* [Mycal Restructuring: The Confusion Continues], *NIHON KEIZAI SHIMBUN*, Oct. 5, 2001, at 3 (providing a graphic that details change in Mycal presidents from the time of bankruptcy filing, as well as the change in the company's financial advisors from Daiwa Shoken SMBC to Nikko Salomon Smith Barney. By September 27, Daiwa Shoken SMBC was only able to secure a single loan of ¥10 billion from one of its own overseas affiliated companies.); *Maikaru: Shien Kigyō Sagashi Nankō, Yamashita Shachō Jinin Happyō* [Mycal, Trouble Finding a Supporting Business, President Yamashita Announces Resignation], *NIHON KEIZAI SHIMBUN*, Sept. 28, 2001, at 1 [hereinafter *Mycal, President Yamashita Announces Resignation*]; *Maikaru Yamashita Shachō, Jinin Mōshide* [Mycal's President Yamashita Tenders Resignation], *NIHON KEIZAI SHIMBUN*, Sept. 28, 2001, at 11; *see also* Yamashita, *supra* note 12, at 142 (explaining Yamashita's reasons for resigning so as to repair relations with DKB and restore transparency to the procedures for selecting a sponsor for Mycal).

creditors refused to continue supplying Mycal with the products it desperately needed to keep its shelves stocked.²⁷ Mr. Yamashita's brief tenure as president, therefore, met with unease from the start. Onlookers even expressed concern about moral hazard, in particular the possibility that current management was obscuring its responsibility by filing under the Civil Rehabilitation Law; so long as Mr. Yamashita was president, no creditors trusted Mycal.²⁸

Interestingly, Mycal's counsel in the Civil Rehabilitation proceedings, Takashi Ejiri, announced his resignation as the company's representative on the same day as President Yamashita.²⁹ Ejiri had been intimately involved with Yamashita and Mycal on past occasions, including efforts to diversify Mycal's sources of financing away from bank loans via the issuance of corporate bonds, as well as Mycal's pre-bankruptcy tie-up negotiations with Wal-Mart.³⁰ Ejiri's involvement in the company's restructuring provoked both creditors

27. *Shikin Kuri Sadamarazu: Tana Ni Ha Keppin, Uriage Gen* [Can't Find Financing: Empty Shelves, Sales Down], ASAHI SHIMBUN, Oct. 13, 2001, at 13 (suggesting that repairing relations with its main financial backers appeared to be the only way Mycal could maintain relations with suppliers). Wholesalers independently have devised their own systems for rating the credit-worthiness of retailer customers like Mycal, taking into account factors such as capital ratios and product turnover. *Dokumento: Maikaru Hatan #5, Tsuyomaru Shijyō No Atsuryoku* [Mycal Bankruptcy Feature, Part 5: Strengthening Market Pressure], NIHON KEIZAI SHINMBUN, Sept. 20, 2001, at 5. Large suppliers such as Itochu Shokuhin and Kato Sangyo had already demanded payment three times per month from Mycal beginning in June, 2001. *Id.*; see also *Maikaru, Torihiki Keizoku Wo Yōsei: Nōnyū No Miawase No Ugoki Mo* [Mycal Requests Trading Partners Maintain Relations: Some Withholding Supplies], NIHON KEIZAI SHIMBUN, Sept. 16, 2001, at 7; *Maikaru Torihiki Saki Taiō Isogu: Nōhin Teishi Ya Genkin Kessai* [Mycal Responds Quickly to Trading Partners: Supplies Halted and Cash Required for Transactions], NIHON KEIZAI SHIMBUN, Sept. 15, 2001, at 9; *Shiharai Jyōken Wo Kenen: Maikaru Saikensha Setsumekai* [Concerned About The Conditions of Payment: Mycal Creditors Meeting], NIHON KEIZAI SHIMBUN, Sept. 18, 2001, at 13.

Although many experts have observed that the reliance on bank financing has decreased markedly in Japan, this scholarship is mostly from the late 1980s or early 1990s, at the zenith of the bubble economy. It is highly likely that Japan's prolonged economic woes have led many companies desperate for cash to restore main bank relations. See Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871, 880 n.38 (1993).

28. *Maikaru Shachō Jinin, Tsunagi Yūshi Hikikae Ni* [Mycal's President Resigns in Exchange for Financing], NIHON KEIZAI SHIMBUN (evening ed.), Sept. 28, 2001, at 3; see also Interview with Hideyuki Sakai, Founding Partner of The Law Offices of Hideyuki Sakai, in Tokyo, Japan (Dec. 14, 2001) (explaining that the source of the moral hazard concern was that if indeed a foreign retailer such as Wal-Mart took over Mycal, it would have no local resources of its own and would be more likely to keep current management. Yamashita had been heavily involved in the negotiations with Wal-Mart since early 2001.).

29. *Mycal, President Yamashita Announces Resignation*, *supra* note 26, at 1.

30. *Maikaru Urano Taisei He Ikō* [Mycal, Switching to Urano's Leadership], NIHON KEIZAI SHIMBUN, Sept. 29, 2001, at 9.

and even fellow lawyers on Mycal's bankruptcy representation team to protest about a possible conflict of interest, and his resignation was just as crucial for restoring confidence in Mycal's management as Mr. Yamashita's.³¹

D. The Search for a Sponsor

With President Urano now at the helm, Mycal and its lawyers began the process of finding another business to take over the failed retailer and restore the confidence of banks and creditors. Hideyuki Sakai, a prominent Japanese bankruptcy lawyer who assumed the lead of representing Mycal in its reorganization proceedings upon Mr. Ejiri's resignation, pursued the strategy of choosing a sponsor via closed bidding.³² In order to acquire more funds to pay off creditors, Sakai and Mycal's legal team attempted to increase Mycal's purchase price by prohibiting participants in the bidding from comparing bids with their competitors.³³ Roughly twenty Japanese and international retailers and investment funds submitted first round bids. Although the identities of the participants were kept secret, it was widely speculated that the top candidates included American retail giant Wal-Mart Stores and the Japanese supermarket chain Aeon.³⁴ The scale of what was up for grabs in the bidding was unprecedented in the Japanese retail industry: at the time of the bidding Mycal directly operated over 140 stores, the majority of which were opened in the 1990s, with total annual sales of approximately ¥800 billion (\$6.67 bil-

31. *Id.*; see also Takehiko Sawaji & Hiroki Yoshida, *Bankruptcy lawyers hold key to future of failed firms*, INT'L HERALD TRIBUNE, Dec. 11, 2001, at 23.

32. *Maikaru, Shien Kigyō Wo Shiboru [Mycal Reduces Potential Supporters]*, NIHON KEIZAI SHIMBUN, Oct. 13, 2001, at 3.

33. *Maikaru, Saidai No Kanmon [Mycal's Largest Hurdle]*, NIHON KEIZAI SHIMBUN, Oct. 9, 2001, at 11 [hereinafter *Mycal's Largest Hurdle*]; *Maikaru Shien Kigyō Kōho, Mazu 5 Sha Zengo Ni [Mycal Takeover Candidates, First Reduced to Five Companies]*, NIHON KEIZAI SHIMBUN, Oct. 12, 2001, at 11. The bidding strategy employed by Mycal's legal team marked a clear break from past rehabilitation practices in Japan, which previously were the exclusive domain of Japanese banks; the Mycal bankruptcy can be seen as a turning point in this regard as well. Sawaji & Yoshida, *supra* note 31, at 23.

34. *Maikaru Saiken: Suponsā, Sūsha Ni Shiboru [Mycal Restructuring: Potential Sponsors Reduced to a Few Companies]*, ASAHI SHIMBUN, Oct. 13, 2001, at 13; *Maikaru, Shien Kigyō Wo Shiboru [Mycal Reduces Potential Supporters]*, NIHON KEIZAI SHIMBUN, Oct. 13, 2001, at 3. Immediately after it filed for reorganization, Mycal appealed to Wal-Mart to buy its most profitable twenty or so stores, and proposed further business cooperation between the two retailers. Having entered reorganization proceedings, Mycal felt it was a more attractive buy since it would now be able to reduce its heavy interest-bearing debt burden, which had deterred Wal-Mart earlier. *Maikaru, Uorumāto Ni Shien Saiyōsei [Mycal Again Requests Help from Wal-Mart]*, NIHON KEIZAI SHIMBUN, Sept. 17, 2001, at 13.

lion).³⁵ As a result, Japanese retailers were extremely concerned by the prospect of a foreign competitor acquiring a secure footing in their home market via the bidding.³⁶

After the conclusion of the first round of bidding and the paring down of buyout candidates to five on October 12, it appeared to observers that Aeon had the upper hand, although there was no public confirmation from the involved parties. Wal-Mart was reportedly prepared to take over seventy to eighty of Mycal's supermarket stores.³⁷ Aeon, however, was reportedly willing to acquire and restructure not only Mycal's supermarkets, but also its *Saty* department stores and *Vivre* clothing specialty shops. Additionally, Aeon indicated its intention to preserve as many jobs of current Mycal employees as possible.³⁸ As a condition for its offer, however, Aeon demanded that Mycal switch from Civil Rehabilitation to Corporate Reorganization proceedings, and thereby regain the financial support of its main lender for the restructuring process.³⁹

These conditions made it very difficult for Mycal's management to accept Aeon's offer. Less than two weeks after the close of the first round of bidding, the negotiations appeared to have fallen apart. On October 24, Aeon announced that it was declining to take over Mycal because of the complicated ownership status of Mycal's stores, the lack of transparency of past disputes among Mycal's personnel, and Mycal's secrecy regarding the identity of the other takeover candidates.⁴⁰ Wal-Mart was considered an even more awkward fit for

35. *Mycal's Largest Hurdle*, *supra* note 33, at 11.

36. *Id.*; see also *Ion, Maikaru Saiken Wo Shien: Kokunai Sandai Sūpā Jidai Ni* [*Aeon Supports Mycal's Restructuring: Entering the Age of Three Giant Supermarket Chains*], *NIHON KEIZAI SHIMBUN*, Nov. 24, 2001, at 9 (suggesting that simply preventing Wal-Mart from establishing a foothold in Japan was a victory for Aeon).

37. *Maikaru, Shien Kigyō Wo Shiboru* [*Mycal Reduces Potential Supporters*], *NIHON KEIZAI SHIMBUN*, Oct. 13, 2001, at 3.

38. *Id.*

39. *Nyūsu Naruhodo: Maikaru Shien Kigyō Ni Ion, Hyōryū Habanda Hozen Kanrinin* [*"You Don't Say?" News: Aeon Supports Mycal, and the Trustee Who Prevented a Breakdown*], *NIHON KEIZAI SHIMBUN*, Dec. 4, 2001, at 3. 7-Eleven Japan operator Ito Yokado apparently offered to take over only Mycal's most profitable stores, but it was willing to do so under the auspices of Civil Rehabilitation proceedings. *Id.*

40. Most of the stores that Aeon was considering purchasing had been securitized by Mycal, so their ownership status was complicated and the possibility existed that the final amount Aeon would have to pay for the stores could increase. *Maikaru Ukezara Kōshō, Ion, Jitai Tsūkoku* [*Aeon Declines Mycal Takeover*], *ASAHI SHIMBUN*, Oct. 25, 2001, at 3; *Maikaru Ukezara Sagashi Konton* [*Chaos in Finding Mycal Successor*], *ASAHI SHIMBUN*, Oct. 26, 2001, at 13 (Mycal's representative Mr. Sakai expressed doubt that any potential, undisclosed bidder would in fact drop out of the negotiations at such an early stage.).

Mycal as the U.S. retailer's stores are huge, one-floor warehouses in suburban areas with relatively low property values. Wal-Mart was unlikely to find attractive the construction and location of Mycal's expensive, mostly multi-story stores built near Japan's urban train stations.⁴¹ In addition, the negative impact of the September 11, 2001 terrorist attacks on the U.S. economy and consumer demand further decreased the feasibility of Wal-Mart's making a large-scale investment in the Japanese market.⁴² However, despite Aeon's announcement and widespread pessimism about Wal-Mart's takeover, the negotiations continued.

Finally, on November 22, Aeon announced that it would indeed acquire Mycal, but only on its long-held condition that the retailer switch bankruptcy proceedings in order to gain the support of DKB.⁴³ Mycal thus became the first company in Japanese history to switch from Civil Rehabilitation to Corporate Reorganization proceedings.⁴⁴ Despite going through three presidents in two weeks, alienating itself from its main bank, and wasting over two months groping for new lenders or potential takeover candidates in the process, Mycal's management was forced to crawl back to DKB for financial support, and to file under the bankruptcy proceedings it had initially tried to avoid.⁴⁵ As President Urano explained to reporters, "[W]e chose the Civil Rehabilitation law in the hopes of quickly restructuring, but the weakening of our stores progressed faster than we had expected."⁴⁶ Without the support of its main bank, Mycal was unable to maintain

41. *Maikaru Ukezara Sagashi Konton* [Chaos in Finding Mycal Successor], ASAHI SHIMBUN, Oct. 26, 2001, at 13.

42. *Id.*

43. *Ion, Maikaru Shien: Kōseiō Ni Henkō, Dai-Ichi Kangin Mo Shikin Kyōryoku He* [Aeon to Takeover Mycal: Switch to Corporate Reorganization Law, Dai-Ichi Kangyo Bank to Provide Financial Support], NIHON KEIZAI SHIMBUN, Nov. 23, 2001, at 1; *Aeon bails out Mycal to grab top spot*, NIKKEI WKLY., Nov. 26, 2001, at 2.

44. *Aeon bails out Mycal to grab top spot*, *supra* note 43, at 2.

45. *Ōhaba Risutora Fukaketsu, Ion Ga Maikaru Shien* [Aeon Supports Mycal, Extensive Restructuring Inevitable], NIHON KEIZAI SHIMBUN, Nov. 23, 2001, at 11; *Aeon bails out Mycal to grab top spot*, *supra* note 43, at 2.

46. *Aeon Supports Mycal, Extensive Restructuring Inevitable*, *supra* note 45, at 11. Over forty of Mycal's stores directly competed with Aeon's, so it was widely speculated that despite Mycal's insistence on a takeover candidate to preserve as many stores and jobs as possible, Aeon would make serious cutbacks. *Id.* At the time it filed for bankruptcy, Mycal's management assumed that roughly 100 of its 140 directly operated stores were profitable, but two months later only ten to twenty of its stores were operating in the black, according to Aeon and Ito Yokado. *Ion, Maikaru Saiken Wo Shien: Kokunai Sandai Sūpā Jidai Ni* [Aeon Supports Mycal's Restructuring: Entering the Age of Three Giant Supermarket Chains], NIHON KEIZAI SHIMBUN, Nov. 24, 2001, at 9.

relations with its suppliers or complete a takeover deal with Aeon, and in the end it was forced to choose between swallowing its pride or closing its doors.⁴⁷

III. MYCAL AND THE CORPORATE BOND MARKET

A. The Impact of Mycal on Japan's Corporate Bond Market

Of Mycal's total debt burden, ¥350 billion (over \$2.9 billion) was in the form of outstanding straight bonds, making Mycal the largest public debt default in Japanese history.⁴⁸ Although the majority of Mycal's bonds were placed with institutional investors, over ¥90 billion (\$750 million) worth of bonds were sold to over 35,000 individual investors.⁴⁹ Japanese credit rating agency R&I rated Mycal's credit BBB- at its February fiscal year-end, meaning repayment of its debt was deemed sufficiently certain, and making the bonds investment grade.⁵⁰ In June, however, R&I lowered Mycal's credit rating four places to B+, several notches into junk bond status, indicating that its ability to repay its debts was in serious doubt.⁵¹ Japan Credit Research (JCR), another Japanese credit rating agency, did not lower its rating of Mycal's bonds from investment grade BBB to BB until August 17, 2001, less than a month before Mycal's bankruptcy.⁵²

47. Although DKB's inability to intervene and restructure Mycal before it filed for bankruptcy is a sign of the main bank system's decline due to the current financial weakness of banks, the fact that Mycal had little hope of restructuring, even through formal insolvency proceedings, without its main bank's support shows how deeply ingrained the main bank system is.

48. *3500 Oku En Saimu Furikō: Maikaru Sai, Kōbosai De Saidai* [350 Billion Yen Debt Default, Mycal Bonds, Worst Public Debt Default Ever], NIHON KEIZAI SHIMBUN, Sept. 15, 2001, at 1.

49. *Maikaru Sai Hoyū 3 Man 5000 Nin Chō* [Over 35,000 Individual Investors Hold Mycal Bonds], NIHON KEIZAI SHIMBUN, Oct. 31, 2001, at 7. Mycal issued ¥40 billion and ¥50 billion worth of bonds aimed at individual investors in January and October 2000, respectively. Nomura Securities bore the brunt of the individual investor loss, as it sold over ¥60 billion worth of Mycal's bonds to over 23,000 of its investors. *Id.*

50. Akira Ikeya, *Government cracks down on bad loans*, NIKKEI WKLY., Sept. 24, 2001, at 1, 2; *Shasai Kakuzuke Tsunoru Fushinkan* [Corporate Debt Credit Ratings are Gathering Mistrust], ASAHI SHIMBUN, Oct. 23, 2001, at 9 (providing a useful graph showing Mycal's declining share price and slipping credit rating throughout 2000 and 2001).

51. Ikeya, *supra* note 50, at 2; *Shasai Kakuzuke Tsunoru Fushinkan* [Corporate Debt Credit Ratings are Gathering Mistrust], ASAHI SHIMBUN, Oct. 23, 2001, at 9.

52. *Fukusū Hikaku No Hitsuyō Mo* [Comparing Multiple Ratings Necessary], ASAHI SHIMBUN, Oct. 23, 2001, at 9 (quoting the chief analyst for JCR as saying, "[I]n our credit report we wrote some very negative evaluations of Mycal, but it seems they weren't effectively communicated to investors. We're looking into ways to change our ratings symbols so that investors don't just see A or BB, but understand our forecast for the company."); *Shasai Kakuzuke Tsu-*

Numerous Japanese companies were also caught holding Mycal's straight bonds, and were forced to write off their entire face value (e.g., Shinkin Central Trust and Seino Transport, which held ¥6.1 billion (\$50.8 million) and ¥3 billion (\$25 million) worth of bonds respectively).⁵³ The Shutoken Shintoshi Tetsudo Company, a third sector, government-supported company charged with building a new train line into Tokyo, purchased bonds guaranteed by Mycal and issued by an affiliated company in 1997 and 1999 worth a total of ¥11 billion (\$91.7 million).⁵⁴ At the time of purchase, Mycal's credit rating was A.⁵⁵ Meiji Dresdner Asset Management Company's Money Management Fund became the second money management fund ever in Japan to fall below investors' purchase prices, declining over ¥20 billion (\$167 million) in value to ¥37 billion (\$308 million) because it held many Mycal bonds.⁵⁶

Although Mycal's bankruptcy caught many investors by surprise, the warning signs were evident. For example, in July 2001, one of Mycal's ¥100 face value bonds, due to mature in 2008, was trading at ¥33 (\$0.28), a third of its face value.⁵⁷ In theory, investors would still have been able to recoup the full ¥100-value of the bond if they had held on until maturity, but they were instead scrambling to sell because of Mycal's credit rating downgrade to B+ from BBB- in June.⁵⁸

The Mycal bankruptcy had an immediate effect on the entire Japanese bond market and caused many companies with low credit ratings to turn away from the increasingly expensive debt market and back to bank financing.⁵⁹ Although straight bond issuance for the

noru Fushinkan [Corporate Debt Credit Ratings Are Gathering Mistrust], ASAHI SHIMBUN, Oct. 23, 2001, at 9.

53. *Maikaru Muke Saiken Hoyu Kigyō, Aitsugi Sonshitsu Keijyō He* [Numerous Companies Holding Mycal Debt Reporting Losses], NIHON KEIZAI SHIMBUN, Sept. 19, 2001, at 17; *Maikaru Muke Saiken Hōyū Kigyō, Shinkin Chūkin 61 Oku En* [Companies Holding Mycal Bonds, Shinkin Chūkin 6.1 Billion Yen], NIHON KEIZAI SHIMBUN, Sept. 20, 2001, at 17 (by September 19, the list of companies holding Mycal bonds grew to twenty-one).

54. *Shasai Kakuzuke Tsunoru Fushinkan* [Corporate Debt Credit Ratings Are Gathering Mistrust], ASAHI SHIMBUN, Oct. 23, 2001, at 9.

55. *Id.*

56. Tsukamoto, *supra* note 3, at 12; *Meiji Doresunā No MMF Kyūgen: Maikaru Sai Kumūre Ganpon Ware* [Sudden Decrease in Meiji Dresdner's MMF: Included Mycal Debt, Below Original Investment], NIHON KEIZAI SHIMBUN, Oct. 3, 2001, at 7.

57. *Dead, or just resting?*, *supra* note 2, at 70; Ikeya, *supra* note 50, at 2.

58. *Dead, or just resting?*, *supra* note 2, at 70; Ikeya, *supra* note 50, at 2.

59. *Kojin Muke Shasai Hakkō Zero: Maikaru Saimu Furikō Hibiku* [No Corporate Debt Issues Aimed at Individual Investors: Mycal's Corporate Debt Default Resounds], NIHON KEIZAI SHIMBUN, Oct. 18, 2001, at 7; Natsumi Tsukamoto, *Activity in low-rated bonds anemic*, NIKKEI WKLY., Oct. 22, 2001, at 13.

seven-month period ending in October, 2001 was expected to reach ¥5 trillion (\$41.7 billion), topping the figure for the same period a year earlier, only bonds rated double-A or higher were seeing any significant investment inflow after September 14.⁶⁰ A credit analyst at Morgan Stanley Japan described the situation by commenting that “a growing number of investors w[ould] not touch triple-B bonds.”⁶¹

After Mycal’s collapse on September 14, there was not a single corporate debt issue aimed at individual investors until October 25, when Sumitomo Real Estate issued a ¥10 billion (\$83 million) bond, which was also October’s first BBB-rated bond.⁶² Despite issuances by over thirty-two companies of corporate bonds for individual investors totalling ¥866 billion (\$7.2 billion) between April and September 2001, a 250% increase on the same period a year before, the six-week period after Mycal’s bankruptcy saw no new activity.⁶³ The market froze, and until Sumitomo Real Estate’s issue, it looked as if October, 2001 would be the first month in thirteen without a single debt issue aimed at individual investors.⁶⁴

By mid-November it was clear that the bankruptcy would have a lasting effect on the bond market. The interest rate spread between Japan’s national debt and issues rated between AAA and AA fell as investors switched to safer bonds with higher credit ratings, while the spread on BBB-rated bonds rose over 0.3% in less than two months as investors dumped them.⁶⁵ The trend showed no sign of slowing.

60. For example, a single A, six-year bond issued by Promise Co. with a coupon hike from the company’s previous issue received a poor response. Tsukamoto, *supra* note 59, at 13.

61. *Id.*

62. *Kojin Muke Shasai Hyakuoku En: Maikaru No Hatango Hatsu [Ten Billion Yen Corporate Debt Issuance Aimed at Individual Investors: First Since Mycal’s Bankruptcy]*, NIHON KEIZAI SHIMBUN, Oct. 26, 2001, at 7.

63. *Kojin Muke Shasai Hakkō Zero: Maikaru Saimu Furikō Hibiku [No Corporate Debt Issues Aimed at Individual Investors: Mycal’s Corporate Debt Default Resounds]*, NIHON KEIZAI SHIMBUN, Oct. 18, 2001, at 7 (containing a graph that shows the precipitous fall in corporate debt issues for individual investors and also describing the negative impact on securities companies, which had been actively marketing such bonds because of their purported safety and relatively high interest (around one percent) for Japan).

64. *See id.*

65. The vice president of Nikko Salomon Smith Barney Securities laments that no matter how appropriately high interest may be relative to risk for bonds with lower credit ratings, investors still will not buy them. *Shasai Tōshi, Shinyō Risuku Ni Binkan [Corporate Bond Investment, Sensitive to Credit Risk]*, NIHON KEIZAI SHIMBUN, Nov. 22, 2001, at 19. Because investors are not buying such bonds, the spread widens further, more investors dump them, and a vicious cycle ensues. *Id.* Investors were also keeping their distance from bonds with lower credit ratings because of the anticipated switch of accounting practices from book to market value, one of Japan’s “Big Bang” financial reforms. *Id.* Many Japanese companies and banks were expected

Companies with a BBB rating apparently found it cheaper to obtain financing elsewhere: bonds rated BBB made up a third of all bond offerings in September, but in the October–November two-month period, they accounted for only one percent of bond issues.⁶⁶ Several well-known companies with good credit ratings of A or A-, including Meiji Dairy Products and Sumitomo Denso, cancelled the issuance of their bonds.⁶⁷

The bankruptcy affected other debt issues as well. By mid-October, the value of subordinated debt issued by Japanese banks had also weakened significantly.⁶⁸ Yen-denominated debt rated below investment grade and issued by foreign governments (Samurai bonds) were also hit heavily: by October 17, the interest on Argentina's samurai bonds due to mature in 2005 was well over twenty percent, almost a fifteen percent increase in less than three months.⁶⁹

Pathetic cases of elderly investors who poured their retirement savings into Mycal bonds, believing that they were safe from default, abounded in the media.⁷⁰ There was a proliferation of news articles

to take big hits as losses on stocks they had been hiding for years would finally have to be reported. *Id.*

66. *Tōshika No Risuku Ishiki Takamaru [Investors' Risk Awareness Heightens]*, NIHON KEIZAI SHIMBUN, Dec. 13, 2001, at 11. By mid-December, the spread on five-year bonds rated BBB was 1.37%, while the spread on five-year bonds rated A was 0.52%, a 0.3% and 0.1–0.15% rise from October's levels, respectively, indicating the increased cost to debt financing. Even Japan's traditionally strong steel and trading companies found the spread on their outstanding bonds increase by as much as 2% from August's levels. Credit analysts predicted this environment would continue for at least half a year. *Id.*

67. *Shasai Hakkō Miokuri Aitsugu, Shinguru A Kaku Sai Ni Mo Hakyū [Corporate Bond Issues Cancelled One After Another, Effect Spreading to Single A Bonds]*, NIHON KEIZAI SHIMBUN, Dec. 13, 2001, at 11.

68. *Ginkō Retsugosai No Ninki Teimei [Popularity of Bank Subordinated Bonds Sinking]*, NIHON KEIZAI SHIMBUN, Oct. 13, 2001, at 15. The interest spread widened because investors were uneasy about the ability of banks to set aside sufficient loss reserves to cover collapses such as Mycal's. *Id.* Of course, Japanese banks have many other problems independent of Mycal. See *supra* notes 1–2. For example, with the Nikkei average dipping below 10,000, major banks' unrealized losses on securities have expanded to around ¥5 trillion (\$41.7 billion). See *Bank's Bad-Loan Bumbling, supra* note 1, at 19. Since banks have long relied on unrealized profits from their stock portfolios to cover non-performing loan losses, the plunging of the stock market is making disposal of bad loans that much more difficult. Some banks are even considering using legally mandated reserves, which have never been used before in Japan, to pay dividends for the current term. *Id.*

69. *Tōshika No Senbetsu Senmei Ni [Selection By Investors Becoming Clear]*, NIHON KEIZAI SHIMBUN, Oct. 18, 2001, at 19. The credit rating on Argentina's debt had fallen to the triple-C zone because of the country's worsening financial situation, exacerbating the already weak market conditions in Japan. The interest rates on Brazil's and Turkey's samurai bonds also increased. *Id.*

70. *Maikaru Hatan De Kojin Ni Higai [Individual Investors Hurt By Mycal Bankruptcy]*, NIHON KEIZAI SHIMBUN, Sept. 30, 2001, at 11; *Shasai Kakuzuke Tsunoru Fushinkan [Corporate*

advising casual investors on how to protect themselves, recommending that investors compare multiple debt ratings before purchasing any corporate bond, and even detailing what to do in case the bond you bought defaults.⁷¹

How could a system meant to appraise accurately the risk of investments have misled so many investors? After the scale of the default and its effects became evident, the overriding sentiment was anger and disbelief. Confidence in the corporate debt market, in credit rating agencies, in corporate trustees charged with looking after investors' interests, and in companies issuing debt themselves, was severely shaken.

IV. MYCAL IN CONTEXT: JAPAN'S BOND MARKET

A. Background

Mycal's default had such a large impact on Japanese investors and the Japanese corporate debt market as a whole because of the unsecured bond market's relative youth and investors' resultant underdeveloped appreciation of risk. There still exists in Japan a strong tendency to view credit ratings as simply a black-and-white indicator distinguishing between dangerous companies that are likely to default (those rated below BBB) and safe companies that cannot, or will not be allowed to, fail.⁷² In fact, credit rating agencies were not established in Japan until the mid-1980s, before which a central committee performed the credit-rating function.⁷³ Mycal's collapse was thus a

Debt Credit Ratings Are Gathering Mistrust], ASAHI SHIMBUN, Oct. 23, 2001, at 9 (revealing that many elderly investors believe that bonds are safe from default so long as they are rated investment grade, and this false sense of security combined with the relatively high rate of interest compared to bank accounts makes them popular investment tools).

71. *Fukusū Hikaku No Hitsuyō Mo* [Comparing Multiple Ratings Necessary], ASAHI SHIMBUN, Oct. 23, 2001, at 9; *Maikaru Hatan De Kojin Ni Higai* [Individual Investors Hurt By Mycal Bankruptcy], NIHON KEIZAI SHIMBUN, Sept. 30, 2001, at 11. The article includes a table listing helpful information about major straight debt issuances to individual investors in 2001, including the bonds' credit ratings, and giving five tips to avoid failing in corporate bond investments: (1) pay attention to the amount of the issue and interest rate, (2) if you are uneasy purchase a bond with a shorter maturity date, (3) keep close watch of the bond issuer in case its credit rating falls, (4) pay attention to the issuer's stock price, and (5) consider selling the bond before it reaches maturity.

72. MARIKO KODAMA, SHASAI KAKUZUKE NO CHISHIKI, SHINYŌ RISUKU KANRI NO JISSAI [KNOWLEDGE ABOUT BOND CREDIT RATINGS, THE ACTUAL MANAGEMENT OF CREDIT RISK] 111 (1995).

73. See *id.* at 50–52. Japanese credit rating agencies established in the 1980s include The Japan Corporate Debt Research Institute, sponsored by the Nikkei Shimbun (1985), Japan Investors Services (1985), and the Japan Credit Research Institute (1985). See *infra* text accom-

shock to Japanese investors and has resulted in widespread skepticism about whether or not credit ratings accurately portray a company's financial condition.⁷⁴

It was not until the end of the bubble economy and the early 1990s that most Japanese investors began to become aware of the credit risk inherent in corporate debt at all, in large part because the number of Japanese companies issuing debt in this period greatly increased.⁷⁵ Between 1983 and 1993, the percentage of Japan's listed companies with bonds outstanding doubled.⁷⁶ Changes in the types of debt issued also kept pace with the rapid increase in sheer amount. In 1989, at the peak of Japan's bubble economy, domestic convertible debt (*kokunai tenkan shasai*) and foreign bonds with warrants attached (*waranto sai*) accounted for 77.9% of all bond issuances, totaling ¥15.9 trillion (\$132.5 billion). By 1997, however, these two categories of debt accounted for only 2.4% of Japanese bond issuances, totaling only slightly over ¥270 billion (\$2.25 billion).⁷⁷ Taking their place were straight bond offerings (both international and domestic), which increased from ¥1.85 trillion (\$15.4 billion), a 9% share of all corporate bond issues, to ¥10.3 trillion (\$85.8 billion), a 93.2% share of the market, in the same period.⁷⁸

As impressive as these figures are, however, the change from international to domestic bond issues that Japan's bond market underwent is even more staggering. During the 1980s, Japanese companies issued their bonds primarily on international markets, so much so that

panying notes 89–98 (discussing the credit rating role of the *kisaikai*, or bond committee); see also JYUNSUKE MATSUO, *NIHON NO SHASAI SHIJYŌ* [JAPAN'S CORPORATE DEBT MARKET] 75–76 (1999) (pressure from America played a role in the establishment of Japan's domestic credit rating agencies).

74. See, e.g., *Maikaru Hatan De Kojin Ni Higai* [Individual Investors Hurt By Mycal Bankruptcy], *NIHON KEIZAI SHIMBUN*, Sept. 30, 2001, at 11; *Shasai Kakuzuke Tsunoru Fushinkan* [Corporate Debt Credit Ratings Are Gathering Mistrust], *ASAHI SHIMBUN*, Oct. 23, 2001, at 9; Tsukamoto, *supra* note 3, at 12.

75. KODAMA, *supra* note 72, at 46–47. Kodama also cites other related factors spurring investor consciousness of risk, including a widening gap in the financial health of Japanese companies resulting from increased capital investment risk due to the maturation of the Japanese economy, the inability of Japanese main banks to continue bailing out troubled companies, and, what I will focus on shortly, the sweeping reform of the corporate debt system itself in the early 1990s. *Id.* at 47–50. Reform of the corporate debt system made it possible for such a huge increase in bond issuance to occur.

76. *Id.* at 47. In 1983, 500 of Japan's approximately 2,000 listed companies had bonds outstanding, while in 1993 the number had grown to 1,300 of 2,600 listed companies. *Id.*

77. MATSUO, *supra* note 73, at 3, 77–79 (explaining the current state of Japan's corporate debt market, as well as its reform and history since its inception, more clearly and in more detail than any other resource I have found to date).

78. *Id.*

in 1989 only ¥36 billion (\$250 million) worth of straight bonds were issued domestically (excluding bonds issued by electrical utilities), equaling only one-twentieth the amount of foreign currency denominated international straight bonds issued the same year (over ¥770 billion, or \$6.4 billion).⁷⁹ To most Japanese businesses, the domestic straight bond market may as well not have existed.⁸⁰ By 1997, however, issues of Japanese domestic straight bonds (excluding electrical utility issues) had expanded to ¥6.85 trillion (\$57 billion), 190 times their 1989 value, six times the value of all 1997 international straight bond issues, and accounting for 62% of the entire Japanese bond market.⁸¹

This data raises two questions: (1) why did Japanese companies rely so heavily on bonds issued abroad in the 1980s, and (2) why did they suddenly switch to domestic bond issues in the 1990s? The answer is that the Japanese corporate debt system was regulated stiflingly from the end of World War II until the early 1990s, and it was not until that system underwent extensive reform in 1993 that a favorable environment for domestic unsecured debt financing finally came into existence.⁸²

B. Restrictions and Reform

Although an exhaustive survey of the Japanese corporate debt system, its history, and evolution, is beyond the scope of this note, a brief synopsis of its structure is in order before describing the system's recent reform.⁸³ Japanese law governing the issuance of corporate debt is contained primarily in the Commercial Code, between Articles 296 and 341-18.⁸⁴ A separate law, the Secured Corporate Bond Trustee Law (*Tanpo Tsuki Shasai Shintakuhō*), governs the is-

79. *Id.* at 3-4, 78. This figure is more startling considering that ¥30 billion of the ¥36 billion of domestic straight bond issues in 1989 were issued by NTT alone. *See id.* at 78.

80. *Id.* at 4.

81. *Id.*

82. *See id.* at 4-5 (citing the precipitous fall in long term interest rates and stock prices as other factors that contributed to the debt financing boom of the 1990s, but the primary reason for the growth in domestic debt is the extensive reform of its legal framework).

83. *See generally* MATSUO, *supra* note 73, at 20-104 (discussing the history of the development and reform of Japan's corporate debt system from 1900 to the late 1990s); KŌSHASAI HIKIUIKE KYŌKAI [ASS'N FOR UNDERTAKING PUB. CORPORATE DEBT], KŌSHASAI SHIJYŌ NO SHINTENKAI [THE NEW DEVELOPMENT OF THE PUBLIC CORPORATE DEBT MARKET] 16-19 (1996) [hereinafter KŌSHASAI] (providing a table describing the developments of the public corporate debt market); FRANCES MCCALL ROSENBLUTH, FINANCIAL POLITICS IN CONTEMPORARY JAPAN 138-50 (1989).

84. SHŌHŌ, arts. 296-341-18.

suance of secured corporate bonds and establishes laws concerning collateral, trust arrangements, and trustee companies, which are almost always banks.⁸⁵ Although these are the two most important laws concerning corporate debt, a host of other specialized laws also affect the corporate debt system.⁸⁶

The pre-1993 Japanese corporate debt system contained many onerous rules and mechanisms dating back to before World War II, which effectively prevented Japanese companies from utilizing unsecured debt financing, and chose those companies that could issue bonds at all.⁸⁷ During the financial crisis of the late 1920s and early 1930s, many Japanese firms defaulted on their unsecured bonds, leaving bondholders with nothing and contributing to the failure of hundreds of banks.⁸⁸ In response, the thirty or so largest bond-underwriting banks, with the Ministry of Finance's blessing, formed the Bond Issue Arrangement Committee (*kisaikai*) (the Bond Committee) soon after the panic in order to collectively regulate future bond issues.⁸⁹ The core of the Bond Committee consisted of eight major banks (The Industrial Bank of Japan, Mitsui Bank, Mitsubishi Bank, Fuji Bank, Sumitomo Bank, Sanwa Bank, and DKB (then Dai-ichi Bank and the Japan Kangyō Bank)) that enforced a monopoly under which only banks on the committee were permitted, under the committee's own rules, to serve as bond trustees (*shasai boshū no jytutaku gaisha* or *jytutaku ginkō*).⁹⁰ The banks on the Bond Committee also established the "collateral principle" (*yūtanpo gensoku*),⁹¹ which lasted well into the 1980s, requiring that corporate bonds may not be issued without sufficient collateral.⁹² The four major securities companies (Nikko Securities, Nomura Securities, Yamaichi Securities, and Daiwa Securities) that were allowed to collect fees as bond underwriters also had seats on the committee, but only the banks could

85. Tanpō tsuki shasai shintakuhō [Secured corporate bond trustee law], Law No. 52 of 1905.

86. These laws include the Corporate Debt Registration Law (*Shasaitō Tōrokuhō*), Law No. 11 of 1942; the Securities Exchange Law (*Shōken Torihikihō*), Law No. 25 of 1948; and the Corporate Reorganization Law (*Kaisha kōseihō*), Law No. 172 of 1952.

87. KODAMA, *supra* note 72, at 49.

88. ROSENBLUTH, *supra* note 83, at 139. The total number of banks shrunk from 1,283 in 1927 to 538 in 1932. *Id.*

89. *Id.* at 140. See generally MATSUO, *supra* note 73, at 54–56.

90. MATSUO, *supra* note 73, at 55; ROSENBLUTH, *supra* note 83, at 140.

91. MATSUO, *supra* note 73, at 33–38.

92. MATSUO, *supra* note 73, at 36–38; ROSENBLUTH, *supra* note 83, at 140.

earn the fee for managing the collateral.⁹³ The heavy restrictions placed on corporate bonds by the Bond Committee caused a shift in Japanese finance towards bank loans: in 1931 bonds accounted for 29.9% of corporate external funding and bank loans accounted for 13.6%, but by 1936 corporations issued almost no bonds at all, and relied instead on bank loans for 40.6% of their financing.⁹⁴

The Bond Committee also performed a credit rating function by deciding which companies could issue bonds based on a matrix of capital ratios, granting eligibility to a select few corporations.⁹⁵ Because its standards were weighted heavily in favor of companies with large amounts of capital or assets,⁹⁶ from immediately after World War II through the 1960s the Bond Committee preferentially directed debt financing towards Japan's burgeoning heavy industries and electrical utility companies.⁹⁷ The Bond Committee also decided the conditions on which debt would be issued, such as the maturity date and the issue amount, and it set interest rates for corporate debt in line with the Bank of Japan's framework behind national debt, regional government debt, etc.⁹⁸ The Bond Committee thus wielded immense power as the sole entity that decided which companies could issue bonds and on what terms.

Although one would imagine that the securities companies would wield significant influence on the Bond Committee because of their role as financial advisors to bond issuers and as the companies assuming the risk of being bond underwriters, it was the trustee banks that dictated the Bond Committee's policy.⁹⁹ The reason for this was that the banks were by and large the final destination for corporate bonds. In the 1960s the very same banks that were the bond trustees, that set the issuance conditions and chose which companies could issue bonds through the Bond Committee, purchased, on average, 63.4% of bonds issued, and sometimes as much as 80% depending on the issue.¹⁰⁰ As the principal investors, the banks determined the vol-

93. MATSUO, *supra* note 73, at 55; ROSENBLUTH, *supra* note 83, at 140.

94. ROSENBLUTH, *supra* note 83, at 140-41.

95. *Id.* at 144.

96. MATSUO, *supra* note 73, at 54.

97. ROSENBLUTH, *supra* note 83, at 143-44 (noting that the Bond Committee survived both World War II and the Occupation and that from 1947 until 1955, it operated under the control of the Bank of Japan).

98. MATSUO, *supra* note 73, at 54-55.

99. *Id.* at 55.

100. *Id.* (suggesting that the banks' influence as purchasers of the majority of bonds issued in Japan caused many people to refer to bonds as simply another form of bank lending); *see also*

ume of bonds that could be issued each month and ensured that the amount was not enough to cut into their lending business.¹⁰¹ The underwriter securities companies assumed relatively little risk because the banks were the largest investors in bonds. Furthermore, the underwriter securities companies had very little advice for issuers because the banks set the credit ratings, interest rates, and other issue conditions through the Bond Committee.¹⁰²

Although the power of banks through the Bond Committee was especially strong in the 1950s and 1960s, it began to decline from the 1970s onward as individual and institutional investors became a more active force in the bond market,¹⁰³ and as companies began to look for financing alternatives to bank loans.¹⁰⁴ Many of these companies began issuing bonds on the Euromarket, because in contrast to Japan's strict collateral rules and asset requirements enforced by the banks, the Euromarket had no collateral requirement, and its best credit ratings and cheapest financing went to firms with the strongest capital base or low debt-equity ratios.¹⁰⁵ In the early 1970s the Euromarket accounted only for 1.7% of Japanese corporate financing, but by 1984 it accounted for 36.2% of the total.¹⁰⁶

Masahiko Aoki et al., *The Japanese Main Bank System: an Introductory Overview*, in THE JAPANESE MAIN BANK SYSTEM 1, 13 (Masahiko Aoki & Hugh Patrick eds., 1994) (providing a table listing bank holdings of domestic corporate bonds from 1953–1991 and noting that Japanese banks held more than fifty percent of outstanding domestic bonds through 1970).

101. ROSENBLUTH, *supra* note 83, at 145.

102. MATSUO, *supra* note 73, at 55 (stating that the securities companies were criticized by the banks as simply receiving a “sleeping commission”).

103. *Id.* at 55–56.

104. As Japan's economic growth slowed considerably after the post-oil-shock recession of 1975, companies found that too high a percentage of their corporate earnings went to interest payments on bank loans and began reducing their dependence on them. ROSENBLUTH, *supra* note 83, at 147.

105. *Id.* at 148–49; see also John Y. Campbell & Yasushi Hamao, *Changing Patterns of Corporate Financing and the Main Bank System in Japan*, in THE JAPANESE MAIN BANK SYSTEM, *supra* note 100, at 325, 330. The Ministry of Finance still enforced a matrix of capital and asset requirements, mirroring domestic rules, for Japanese corporations issuing bonds in foreign currencies in the Euromarket. Despite this, obtaining financing by issuing bonds abroad was still cheaper because there was no collateral requirement (and no corresponding bond trustee administration fees), no mandatory prospectus, and because of the numerous flexible rate instruments and swaps that reduced interest rate and exchange rate risks. ROSENBLUTH, *supra* note 83, at 149.

106. ROSENBLUTH, *supra* note 83, at 149. Swiss Franc convertible bonds were the most popular instrument of Euromarket fund raising, as many more companies met their issuance qualifications under the Ministry of Finance's rules. In January 1986, 700 Japanese companies were authorized to issue foreign currency convertible bonds in Europe, while only 80 were authorized to issue unsecured straight Eurocurrency bonds. *Id.*

In February 1979, the liberalization of rules governing the issuance of unsecured debt finally began to gather momentum when Sears and Roebuck issued ¥20 billion (\$167 million) worth of yen-denominated unsecured bonds, the first unsecured bonds issued in post-war Japan.¹⁰⁷ The standards that were drafted to allow Sears and Roebuck to issue its samurai bonds, however, were so strict that in reality only two companies in all of Japan, Matsushita Electric and Toyota Automotive, could meet them.¹⁰⁸ In January 1983, the banks relaxed the standards for issuing completely unsecured convertible bonds (*kanzen mutanpo tenkan shasai*) for the first time, making it possible for twenty-five Japanese companies to issue such bonds. In April 1984, the rules were further relaxed to allow ninety-seven companies to issue unsecured convertible bonds and sixteen companies to issue unsecured straight bonds (*mutanpo futsū shasai*).¹⁰⁹ In January 1985, TDK became the first Japanese company since World War II to issue a completely unsecured straight bond, and later that year the restrictions on debt issuance were relaxed again, increasing to 175 and 57 the number of companies that could issue unsecured convertible bonds and unsecured straight bonds, respectively.¹¹⁰

Although standards dictating which companies could issue unsecured debt were relaxed throughout the mid-1980s, the system was still slow to change, and as mentioned above, companies wishing to issue straight bonds fled to foreign debt markets. Despite relaxation of issuance standards, the Japanese unsecured straight bond market failed to develop because of the dominant position held by Japan's banks that served as corporate bond trustees (*jyutaku ginkō*) under the Secured Corporate Bond Trustee Law.¹¹¹ The banks would have lost their business and authority as trustees for collateral backed secured debt, including the huge fees that they demanded for their trustee services, if a general shift to unsecured debt occurred.¹¹² In the early 1980s, Japanese banks charged an average fee of ¥534 million (\$4.45 million) for trustee services for a seven-year, seven percent in-

107. MATSUO, *supra* note 73, at 75 (as is seen throughout Japanese history in so many different areas, foreign pressure (*gaiatsu*) is often instrumental in promoting reform).

108. *Id.*

109. *Id.*; see also KŌSHASAI, *supra* note 83, at 18–19 (providing a timeline of the reforms).

110. MATSUO, *supra* note 73, at 75.

111. *Id.* Article 2 of the Secured Corporate Bond Trustee Law requires a trustee for the issuance of secured debt. Tanpo Tsuki Shasai Shintakuhō [Secured corporate bond trustee law], Law No. 52 of 1905, art. 2, para. 1. Article 6 requires that in addition to trustee duties, the only business that a trustee may be engaged in is banking. *Id.* art. 6.

112. MATSUO, *supra* note 73, at 75.

terest secured bond with a face value of ¥10 billion (\$83 million), compared to an average fee of ¥92 million (\$760,000) for unsecured bond issuances on the same conditions after the 1993 reforms.¹¹³

One reason that banks' fees were so high was because of their custom of buying back bonds in default and bearing the loss in place of investors.¹¹⁴ Despite having no legal or contractual obligation to do so, trustees would buy back the bonds in default at face value to preserve trust and confidence in the corporate debt market, and then recover the secured corporate debt directly in insolvency proceedings.¹¹⁵ The fees trustees charged were high enough to allow them to buy back bonds in default at little or no cost.¹¹⁶ Because of their dual authority as trustees and main banks, not to mention the high prices they demanded, Japanese banks wielded huge influence over the details of any particular bond issue and prevented companies from issuing unsecured bonds despite the relaxation of issuance restrictions.¹¹⁷

To make matters worse, extremely rigid rules on the amount of debt that could be issued by companies existed in the Commercial Code itself. Article 297 of the pre-1993 Commercial Code limited the total amount of debt that could be issued to the lesser of either a company's "capital or cash reserves" or "net assets that exist accord-

113. *Id.* at 81 tbl.2-2 (comparing trustee service charges for Japanese banks).

114. *Id.* at 75. Bonds were seen as a close hybrid of direct lending because (1) banks were the main investors in bonds in the post-war growth period; (2) the bond issuer's main bank was usually the bond trustee or guarantor; and (3) the banks exerted great control over bond issues through the Bond Committee. Therefore, when a bank trustee bought back bonds in default, it was mostly from other banks, and the bond buy back was usually done in coordination with paying off loans to those banks as well. As individual and institutional investors became more active in the bond market in the 1970s and 1980s, however, the role of banks as the main purchasers of bonds decreased, as did the necessity to buy back bonds in default from other banks. *See id.* at 103-04.

The practice of main bank trustees repurchasing bonds in default can also be viewed as an example of residual risk-bearing by the main bank, resulting from its role as the delegated monitoring and intervention agent in Japan's capital markets. *See* Paul Sheard, *The Main Bank System and Corporate Monitoring in Japan*, 11 J. ECON. BEHAV. & ORG. 399, 411-12 (1989). From 1984 through 1991, over sixty percent of the bonds that Japanese banks guaranteed were for their main bank clients, while firms turned more than seventy percent of the time to their main bank for bond guarantees; the figures for main banks serving as bond trustees were similarly high. *See* Campbell & Hamao, *supra* note 105, at 345-49. It follows, then, that the end of the practice of trustees buying back bonds in default can also be interpreted as a signal of the declining role of main banks as monitoring and intervention agents in today's economically troubled Japan.

115. *See* KODAMA, *supra* note 72, at 23.

116. MATSUO, *supra* note 73, at 75.

117. *Id.*

ing to its final balance sheet,” and maintained this restriction since the Meiji-era reforms in 1899.¹¹⁸ In other words, if a company wished to issue new bonds, the total amount of its outstanding bonds, plus the amount of new bonds it wanted to issue, could not exceed the lesser of either its capital or cash reserves or net assets.¹¹⁹ This strict system sought to protect the interests of bondholders by preventing companies from issuing debt in excess of their capital or assets.¹²⁰

The system was liberalized somewhat in 1977, when the passage of the Temporary Law on Corporate Debt Issuance Limits (*Shasai hakkō gendo zantei sochihō*)¹²¹ allowed regular corporations to issue twice the amount of debt otherwise allowed in Article 297, but only if the debt was secured corporate bonds, convertible bonds, or foreign bonds.¹²² Throughout the 1980s, securities companies and general industry representatives pushed hard for the abolition of the Commercial Code bond issuance limits and met resistance from the trustee bank industry through a mouthpiece research committee composed of scholars and Ministry of Legal Affairs bureaucrats.¹²³

As a result of this rigid and expensive system and the glacial progress of reform, Japanese companies fled to foreign markets to obtain financing en masse, as described earlier, primarily to issue straight bonds.¹²⁴ Realizing the gravity of the situation, the Corporate Debt Special Committee of Japan’s Securities and Exchange Commission

118. See SHŌHŌ, art. 297, para. 1, 2 (repealed 1993), reprinted in SATOSHI AIZAWA, WAKARIYASUI KAISEI SHŌHŌ NO KAISETSU [EXPLANATION OF THE COMMERCIAL CODE REFORM MADE EASY] 20–21, 327 (1993) (contrasting the language of the law before and after the 1993 reform).

119. SHŌHŌ, art. 297, para. 1, 2 (repealed 1993), reprinted in AIZAWA, *supra* note 118, at 327; see also MATSUO, *supra* note 73, at 84–88.

120. AIZAWA, *supra* note 118, at 327–28.

121. *Shasai hakkō gendo zantei sochihō* [Temporary law on corporate debt issuance limits], Law No. 49 of 1977, available at http://www.shugiin.go.jp/itdb_houritsu.nsf/html/houritsu/08019770527049.htm (last visited Apr. 14, 2002).

122. MATSUO, *supra* note 73, at 85. With the passage of the Special law concerning Corporate Debt Issuance Limits for General Electric Companies, electric companies were allowed to issue up to six times the limitation in Article 297 starting in 1985. *Ippan denki jigyō kaisha no shasai hakkō gendo ni kansuru tokureihō* [Special law concerning corporate debt issuance limits for general electric companies], Law No. 93 of 1985, available at http://www.shugiin.go.jp/itdb_houritsu.nsf/html/houritsu/10319851207093.htm (last visited Apr. 14, 2002).

123. MATSUO, *supra* note 73, at 87. Industry’s criticisms of the Commercial Code issuance limits included (1) it was illogical to place limits on the incurrence of debt via issuing bonds when there are no limits to the debt that companies could amass by any other means; (2) basing debt issuance limits solely on the value of a company’s assets ignored companies “going concern” value and growth and profit-making potential; and (3) by abolishing the limits, the credit risk of corporate bonds could be judged accurately by the market. *Id.* at 87–88.

124. *Id.* at 76–80.

released a report in late 1986 entitled “Concerning the Ideal Corporate Debt Market” (*Shasai hakkō shijō no arikata ni tsuite*).¹²⁵ As reasons for the decline in the domestic bond market, the report cited several factors, including: (1) compared to foreign markets, Japan has far more legal and customary restrictions; (2) the versatility of bond issuance conditions is insufficient; and (3) the collateral principle (*yūtanpo gensoku*) still persists.¹²⁶ The report based its reform suggestions on the principles of internationalization, liberalization, and protection of investors. Its proposals included the reevaluation of the collateral principle, improvement of the mechanism for bond issuance, clarification of the functioning of the trustee system, promotion of the diversification of corporate bonds, and relaxation or abolition of the Commercial Code limits on bond issuance.¹²⁷

In April 1990, reform began in earnest as the Diet passed the Proposed Law Revising Part of the Commercial Code (*shōhōtō no ichibu wo kaisei suru horitsuan*), which went into effect in June of the same year.¹²⁸ The law removed the “capital or cash reserve” prong from the Article 297 bond issuance limits, and doubled the amount of convertible bonds or bonds with warrants attached that could be issued.¹²⁹

It was the passage of the 1993 reform, however, that truly opened up Japan’s corporate debt market. The Law Revising Part of the Commercial Code, or simply the Commercial Code Reform (*kaisei shōhō*), promulgated in June of 1993, not only abolished the long-standing bond issuance limitations under Article 297, but also implemented fundamental reform of the corporate bond trustee system, without which the revitalization of Japan’s unsecured bond market could not have occurred.¹³⁰

125. *Id.* at 80 (citing CORPORATE DEBT SPECIAL COMM, SEC. & EXCH. COMM’N, CONCERNING THE IDEAL CORPORATE DEBT MARKET (1986) (Jap.)).

126. *Id.*

127. *Id.* at 81–82.

128. *Id.* at 88; *Shōhōtō no ichibu wo kaisei suru horitsuan* [Proposed law revising part of the commercial code], Law No. 64 of 1990, available at http://www.shugiin.go.jp/itdb_houritsu.nsf/html/houritsu/11819900629064.htm (last visited Apr. 14, 2002).

129. MATSUO, *supra* note 73, at 88. As the net assets of most companies far exceed the capital or cash reserves on hand, it was expected that this reform would increase the debt issuance limits by an average of about 2.4 times.

130. *Shōhōtō no ichibu wo kaisei suru horitsu* [Law revising part of the commercial code], Law No. 62 of 1993, available at http://www.shugiin.go.jp/itdb_houritsu.nsf/html/houritsu/12619930614062.htm (last visited Apr. 14, 2002); see also AIZAWA, *supra* note 118, at 11–17. The Temporary Law on Corporate Debt Issuance Limits and sections of other current laws that

The reform replaced the previous terminology for trustee (*shasai boshū no itaku gaisha*) with a new title, Corporate Bond Management Company (*shasai kanri gaisha*). It also more clearly established a trustee's functions as managing bonds after issuance, and not being involved with negotiating the terms of the issuance.¹³¹ One of the largest hindrances to the liberalization of the unsecured debt market before the reform was the strong influence that trustee banks had over setting the terms of bond issues and the high trustee service fees that resulted.¹³² This was due in part to the vagueness in phrasing of the old Japanese provision describing the duties of a trustee, which had been interpreted to allow banks to expand their trustee duties beyond just the management of bonds and protecting bondholders' interests.¹³³ The new law therefore limited the business of trustees to managing bonds after issuance and created extremely important room for securities companies to finally step in and fill the financial advisor role of deciding the conditions for a bond issue.¹³⁴ Examples of functions that had been performed by trustee banks before the reform, and that now became the work of underwriters, included the running of extensive checks on the issuer to confirm that it qualified under the Ministry of Finance guidelines for debt issuance and setting the financial conditions for the bond (capital maintenance ratios, restrictive covenants, etc.).¹³⁵

In addition, the reform expanded the pool of companies that can serve as trustees to include not only banks and trust companies, which had been permitted before, but also companies that have received a trustee license under the Secured Corporate Bond Trustee Law.¹³⁶ This change was intended to lower trustees' high fees, as it was expected that increasingly more companies would receive trustee licenses.¹³⁷

The reform succeeded in greatly reducing trustee service charges. In the early 1980s, a seven-year unsecured bond with a face value of

limited debt issuance were also abolished. *Id.* at 11. See generally MATSUO, *supra* note 73, at 95–104.

131. MATSUO, *supra* note 73, at 95–97.

132. AIZAWA, *supra* note 118, at 12.

133. *Id.*

134. MATSUO, *supra* note 73, at 95–97; AIZAWA, *supra* note 118, at 13.

135. MATSUO, *supra* note 73, 97–98.

136. SHŌHŌ, art. 297-2; see also MATSUO, *supra* note 73, at 95; AIZAWA, *supra* note 118, at 14.

137. MATSUO, *supra* note 73, at 95–97; AIZAWA, *supra* note 118, at 14.

¥10 billion (\$83 million) cost ¥318 million (\$2,650,000).¹³⁸ After the reforms the fee for the same bond had fallen to ¥43 million (\$358,000).¹³⁹ Thus, the reforms were extremely effective in breaking the trustee banks' requirement that all bonds be secured, in lowering the cost of issuing bonds, and thereby spurring the revitalization of the domestic bond market.

C. Risk Appreciation

In light of this sudden liberalization of the Japanese bond market, and the resulting boom in debt financing discussed above, it is little wonder that the general appreciation of risk on the part of the average Japanese investor is poorly developed. Between 1945 and 1995, there were only twenty cases of default on corporate bonds in Japan, and only nine of them occurred before 1980.¹⁴⁰ Far more remarkable than this small number of defaults, however, is the fact that until 1984, when Riccar Company defaulted on a small amount of Swiss Franc denominated unsecured convertible bonds, Japanese investors never had to bear the loss on their principal and interest when their bonds defaulted.¹⁴¹ There was neither a guarantor with a contractual obligation to compensate investors for the lost principal and interest, nor a trustee willing to voluntarily buy back Riccar's bonds at face value and bear the concomitant loss itself in order to preserve investors' trust.¹⁴² Thus, a precedent of investors bearing the loss of a bond default was set, but it was not until Mycal's collapse in 2001 that a default caused heavy financial losses to individuals.¹⁴³

138. MATSUO, *supra* note 73, at 101, 240–45. This figure included ¥175 million of fees for trustee services in relation to collateral—in the early 1980s no completely unsecured debt was issued.

139. *Id.* at 101–02.

140. KODAMA, *supra* note 72, at 19.

141. *Id.* at 22; see also *Kaigai CB Mo Shōkan Katto: Rikka Wagi Shinsei, Hamon Hirogaru* [International Convertible Bond Payback Cut: Impact of Riccar's Composition Filing Spreads], NIHON KEIZAI SHIMBUN, July 25, 1984, at 16 (Riccar's default was the first time that the repayment of outstanding convertible bonds incurred a cut in principal and interest) [hereinafter *Kaigai CB*].

142. KODAMA, *supra* note 72, at 24. Riccar's conditions for repayment of the bonds were (1) exemption from paying interest; (2) a forty percent cut in principal; and (3) a deferred payment period for the remaining sixty percent of principal. See *Kaigai CB*, *supra* note 141, at 16. Banks that served as either trustee or guarantor for a company's bond issue were usually its main bank. See discussion *supra* note 114.

143. Riccar's total debt burden at the time it filed for bankruptcy was ¥82.6 billion (\$688 million), less than one twentieth of Mycal's, although at the time Riccar was Japan's fourth largest post-war bankruptcy. *Hyōmen Kuroji, Daidokoro "Hi No Kuruma:" Wagi Shinsei No Rikka* [Profits on the Outside, But a Fire in the Kitchen: Riccar Files for Composition], NIHON KEIZAI

But it is less the actual financial loss suffered by investors in Mycal, and rather the circumstances under which that loss occurred, that has many people questioning the functioning of Japan's corporate bond market. Mycal's unexpected bankruptcy has raised serious doubts about whether corporate bond trustees are taking their duties as protectors of investor assets seriously. Seven banks with outstanding loans to the failed retailer, including Mycal's main lender DKB, serve as trustees for Mycal bonds, and there is suspicion that these banks were trying to collect on the collateral backing their loans beginning several days before the company filed for court protection.¹⁴⁴ In particular, DKB is suspected of violating its trustee duties to bondholders when it extended ¥50 billion (\$417 million) of loans to Mycal in August, 2001.¹⁴⁵ Mycal sold uncollateralized parent firm assets to one of its subsidiaries and then offered these assets as collateral for the August loan, in an apparent attempt to circumvent an equal and ratable clause attached to its corporate bonds.¹⁴⁶

DKB's status as a creditor-trustee creates a conflict of interest from which bondholders in the United States are protected by the Trust Indenture Act of 1939, and in particular by its provisions prohibiting conflicts of interest for indenture trustees.¹⁴⁷ Injured bondholders also have a federal cause of action under the Trust Indenture Act against a bond trustee for the breach of indenture terms mandated by the Act.¹⁴⁸ Section 310(b)(10), introduced in the Trust In-

SHIMBUN, July 24, 1984, at 9. Only ¥100 million (\$833,000) worth of Riccar's ill-fated unsecured convertible bonds had still not been converted to stock at the time of default. *Kaigai CB, supra* note 141, at 16.

144. Tsukamoto, *supra* note 3, at 12. These banks appear to have a conflict of interest as it is their duty as bond trustees to secure the assets of the bond issuer for repayment to bondholders in the case of default, while it is also in their interest to foreclose on the collateral backing their own secured loans to the issuer. *Id.*

145. *Id.*; Suemura, *supra* note 3, at 83.

146. Tsukamoto, *supra* note 3, at 12; see also *Yameru Kinyu #3: Shasai Shijyō No Kyokō* [*Suffering Finances, Part 3: the Corporate Bond Market's Fabrications*], NIHON KEIZAI SHIMBUN, Nov. 10, 2001, at 1 [hereinafter *The Corporate Bond Market's Fabrications*]. An equal and ratable clause, a provision routinely included in indentures that establish the rights of bondholders, requires that in the event an issuer offers collateral for any new loan or indebtedness, it must post an equal and ratable amount of collateral for the outstanding bonds. By putting the assets up at its subsidiary, Mycal apparently hoped to claim that it did not actually give collateral for the loan, its subsidiary did, and therefore it need not post new collateral for its outstanding bonds. This is a dubious argument.

147. 15 U.S.C. § 77jjj(b)(1)–(10) (1999). A conflict of interest also exists and disqualifies a trustee if, for example, it acts as a trustee under other indentures of the same obligor (§ 77jjj(b)(1)), or if the trustee or any of its executive directors is an underwriter for the obligor (§ 77jjj(b)(2)).

148. See *Zeffiro v. First Pennsylvania Banking & Trust Co.*, 623 F.2d 290 (3d Cir. 1980).

denture Reform Act of 1990, prohibits trustees from being or becoming creditors of the obligor if the obligor falls into default on its bonds.¹⁴⁹ Upon default on the bonds, the trustee has ninety days to eliminate the conflicting interest, and if it is not cured during this time the trustee must resign.¹⁵⁰ The original section in the Trust Indenture Act dealing with creditor-trustees did not prohibit creditor-trustee relationships outright but instead prohibited the trustee from retaining for its own benefit any payments it received in its capacity as a creditor of the obligor within four months before a default in payment occurred.¹⁵¹ Under Section 310(b)(10) of the Trust Indenture Act, DKB would clearly have a conflict of interest as a creditor-trustee of Mycal, and its actions in securing collateral for a fresh loan only a month before Mycal filed for bankruptcy, much less trying to collect on such collateral, would be grounds for bondholders to sue under the indenture.¹⁵²

Japanese law seems to lead to the same conclusion. According to the second paragraph of Article 311-2 of the Commercial Code, if a trustee receives collateral from a bond issuer to secure a debt or loan to the issuer, or if the issuer pays off any debt owed to the trustee, and within three months of providing the collateral or extinguishing the debt the issuer fails to make a payment of principal or interest on its bonds (defaults) or stops making its payments as they become due (becomes insolvent), then the trustee is responsible for the payment of damages to the bondholders.¹⁵³ Furthermore, under the first paragraph of Article 311-2, the trustee is also liable for the payment of damages to bondholders if it violates any other provision of the Commercial Code,¹⁵⁴ which includes the duty of diligence of a good

149. 15 U.S.C. § 77jjj(b)(10); Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, 104 Stat. 2721 (1990); Efrat Lev, *The Indenture Trustee: Does it Really Protect Bondholders?*, 8 U. MIAMI BUS. L. REV. 47, 98-100 (1999) (emphasizing that by setting a post-default conflict of interest standard, the Trust Indenture Act does not adequately protect the rights of bondholders, as a trustee with a conflict of interest may well transfer wealth from bondholders before default actually occurs).

150. See 15 U.S.C. § 77jjj(b); Lev, *supra* note 149, at 99.

151. Trust Indenture Act of 1939 § 311, 15 U.S.C. § 77jjj(b)(11) (amended 1990); see Lev, *supra* note 149, at 98.

152. 15 U.S.C. § 77jjj(b)(10).

153. SHŌHŌ, art. 311-2, para. 2 (the trustee is not responsible for payment of damages to bondholders if it can prove that it did not receive collateral from the issuer or have the issuer extinguish its debt). Note the similarity between this article of the Commercial Code and the U.S. Trust Indenture Act's provision on creditor-trustees before Section 310(b)(10) was added in 1990.

154. SHŌHŌ, art. 311-2, para. 1.

custodian (*zenryō naru kanrisha no chūi gimu*) and the duty of fairness and loyalty (*kohei katsu seijitsu na shasai no kanri gimu*).¹⁵⁵ Under paragraph 2 of Article 311-2, then, DKB should be liable to Mycal's bondholders for receiving collateral within three months before Mycal went bankrupt and defaulted. Even if the fact that the collateral was posted through a Mycal subsidiary exculpates DKB under paragraph 2, it should be liable under paragraph 1 of Article 311-2 for violating both its duty of diligence of a good custodian and its duty of fairness and loyalty. The outcome, however, remains to be seen; as of yet no bondholders have filed suit against DKB for violating its trustee duties.

Why have no bondholders filed suit yet? As previously explained, in Japan bond trustees are usually the bond issuers' main banks.¹⁵⁶ So long as main bank trustees bought back all the bonds in default, as they did until the mid-1980s, there was never any question of conflict of interest, because the bondholders' investment was protected. Now that the practice of buying back bonds in default has ended due to the weakened position of Japanese banks, actions that may once have been lauded as part of the main bank's interventionist and risk-bearing role, such as DKB's extension of fresh credit to Mycal, can now only be seen as defrauding bondholders. But perhaps because of the long existence of the main bank system, Mycal's bondholders don't seem to be in any rush to hold DKB accountable.

To make matters worse, the purpose for issuing the ¥350 billion of outstanding bonds on which Mycal later defaulted was largely to pay back the retailer's loans to its main lender, DKB.¹⁵⁷ Although at first glance it appeared that DKB was forced to take huge losses by stepping in and assuming other banks' loans when Mycal was in trouble, that loss was significantly reduced thanks to the funds raised via Mycal's bonds.¹⁵⁸ The pay back of these loans probably occurred before the three-month window provided in Article 311-2, paragraph 2, however, and therefore is unlikely to be the source of a suit against the trustee.

Mycal's responsibility is heavy as well. Despite being in clearly desperate shape for many months leading up to its bankruptcy filing, Mycal continued to increase its debt burden and dispose of its assets

155. These duties of a trustee are codified in SHŌHŌ, art. 297-3, para. 1, 2. The imposition of liability for violation of these duties is codified in SHŌHŌ, art. 311-2, para. 1.

156. See *supra* discussion at note 114.

157. Suemura, *supra* note 3, at 83.

158. *Id.*

to buy time, eventually leaving little for creditors (except its trustee banks) or bondholders when it finally went bust.¹⁵⁹ Japanese companies, their management practices and predilection to avoid bankruptcy no matter what the cost to creditors and bondholders, as well as the banks that fund them, must share the blame for this chain of events.¹⁶⁰ Considering the staggering numbers of bad loans on the books of Japan's banks, though, it is a near certainty that more companies in the near future will collapse in Mycal's spectacular fashion, after having wasted years and billions of dollars worth of financing to delay the inevitable.¹⁶¹ But the bitter experience of Mycal's collapse and the many bankruptcies to come are also sure to force Japan's immature bond market to grow up in a hurry and to heighten investors' appreciation of risk.

V. CONCLUSION

Japanese investors' appreciation, and perhaps temporary overappreciation, of the risks of corporate bonds in the wake of Mycal's bankruptcy may be seen as an overall positive development. The fact that many Japanese investors considered investment grade bonds to be as safe as savings accounts, with higher interest rates to boot, reveals just how naïve their understanding of the nature of corporate debt was (or, more cynically, it may demonstrate just how deceptively Japanese securities firms have been marketing corporate bonds).¹⁶² As Mariko Kodama, Manager at the Mikuni Offices, a Japanese credit rating agency, says, "[I]t is impossible to distinguish from the beginning whether or not a company will fail. Corporate bond in-

159. *Id.*

160. *Id.*

161. See *Aoki Kensetsu Saiseihō Shinsei He: Fusai Sōgaku 3721 Oku En* [Aoki Construction to File for Civil Rehabilitation: Total Debt 372.1 Billion Yen], *NIHON KEIZAI SHIMBUN* (evening ed.), Dec. 6, 2001, at 1; *Dead, or just resting?*, *supra* note 2, at 70 (detailing Asahi bank's efforts to keep Aoki in the official "in need of monitoring" category and out of the "in danger of bankruptcy" category); *Face value The salvage man*, *ECONOMIST*, Oct. 6, 2001, at 74 (detailing the financial condition of Daiei (now Japan's second largest supermarket chain after Aeon), which is substantially worse than Mycal's). According to Teikoku Databank, Ltd., in 2000 there were 19,071 bankruptcies in Japan, up 23.4% from 1999, carrying a total debt burden of nearly ¥24 trillion (\$200 billion), a 77% increase on the previous year. Teikoku Databank, Ltd., *Zenkoku Kigyō Tosan Shūkei*, 2000 [National corporate bankruptcy statistics, 2000], available at <http://www.tdb.co.jp/tosan/syukei/00nen.html> (last visited Mar. 31, 2002).

162. See *Corporate Debt Credit Ratings Are Gathering Mistrust*, *supra* note 70. The over 20,000 investors who poured their retirement savings into Mycal bonds in exchange for their two to three percent yearly interest had no understanding that they were assuming a bankruptcy risk. See *The Corporate Bond Market's Fabrications*, *supra* note 146, at 1.

vestment must begin on the condition that bankruptcies are inevitable.”¹⁶³

But it is exactly that understanding that has been slow to develop since Japan’s sweeping bond market reform of 1993. Observers of Japan’s economy have warned that one of its most dangerous structural flaws is the widely-believed myth that listed or large companies do not fail.¹⁶⁴ Inevitably a main bank will step in before bankruptcy is unavoidable. The corollary to this principle in Japan’s pre-1993 corporate debt market was that companies “chosen” to issue debt were not allowed to fail.¹⁶⁵ The result of this philosophy is that inefficient companies that should fail are allowed to exist. These colossal debtors continue to consume scarce bank financing when it could be more efficiently used by other companies and spur growth in other industries; their assets continue to be used inefficiently when they should be disposed of and recycled back into the economy. Despite clearly being insolvent, large Japanese companies that should fail refuse to give up and are supported by their main banks well beyond rational limits, thereby decreasing the payout to bondholders when such companies finally do go under.¹⁶⁶ In short, Japanese banks have numerous patients on life support, and until they start pulling plugs when it is clear there is no more hope, it is doubtful Japan’s economy will improve or that bondholders’ rights will be respected.

Mycal’s bankruptcy should be viewed as a turning point in the deconstruction of the myth that large Japanese companies cannot fail, not only in relation to Japan’s main banks that are finally being forced to clear their books of bad loans, but also in regard to how individual Japanese investors approach the corporate debt market.¹⁶⁷

163. *The Corporate Bond Market’s Fabrications*, *supra* note 146, at 1. Kodama’s quote in this article echoes her admonitions to Japanese investors in her book cited frequently in this note. *See generally* KODAMA, *supra* note 72.

164. Suemura, *supra* note 3, at 83.

165. KODAMA, *supra* note 72, at 49.

166. *See, e.g.*, Suemura, *supra* note 3, at 83.

167. Statistics seem to show that the myth is dying: the first nine months of 2001 saw the third-largest number of bankruptcies (14,174) recorded in the January–September period in postwar Japanese history, and nearly a quarter of the companies collapsing are long-established firms that have been in business for thirty or more years. *See Big firms going under in alarming numbers*, NIKKEI WKLY., Nov. 5, 2001, at 4 (“Financial institutions, having supported long-established companies out of consideration for their influence on regional economies, can no longer comply with requests for additional lending from those with no prospect of rehabilitation.”). *But see The Corporate Bond Market’s Fabrications*, *supra* note 146, at 1 (asserting that investors still do not appreciate the bankruptcy risk inherent in corporate bonds, even after Mycal, and that they make bond investment decisions based more on how well-known the company is as opposed to its credit risk).

“If issuers of corporate debt, investors, securities companies, trustees, banks, accountants and credit rating agencies all function under rules based on the principle that ‘bankruptcies happen,’ then even if there is a huge default, at least it will not result in utter panic.”¹⁶⁸ If Japan does eventually manage to extract itself from its current economic abyss, no doubt the demise of Mycal and the wake-up call concerning risk it gave to bond investors, as well as its role in revealing the importance of the principle that “bankruptcies happen,” will be viewed as an important reason why.

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168. Suemura, *supra* note 3, at 83.