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Enterprise Value Mortgage to be Introduced by New Legislation

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I. Introduction

A new law concerning promotion of business cash flow lending (*jigyousei-yuushi no suishintou ni kansuru houritsu*)¹ (the “Act”) was promulgated on June 14, 2024. Its main purpose is to counteract current corporate debt financing’s over-dependence on real estate mortgage and proprietor’s personal guarantee, and thereby support the continuation and growth of business companies. For this purpose, the Act mainly provides for the following:

- (i) Basic government policy on the promotion of business cash flow lending
- (ii) Introduction of enterprise value mortgage (*kigyou-kachi tampoken*)
- (iii) Certification of operators who support and promote business cash flow lending
- (iv) Establishment of new government office that promotes business cash flow lending

In this newsletter, we will focus on enterprise value mortgage (“EVM”), a new type of security interest introduced by the Act.

II. Basic Framework

Financial practices in Japan are expected to develop to provide enough loans to companies that do not own real estate or other tangible assets but have (or are expected to have) sufficient enterprise value – for example, by having valuable intangible assets such as know-how and customer base, over which it

¹ Act No. 52 of 2024. No official English translation of the Act is available.

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is impossible or difficult to create a security interest under the conventional legal framework.

The Act introduces EVM to serve such purpose. The subject assets of an EVM include “all assets” owned by the debtor company.² Any assets that the debtor company acquires after the creation of the EVM will also be included in the subject assets of that EVM, in which regard the EVM has a “floating” nature. As further described later, the going concern value of the debtor company’s business is intended to be maintained as much as possible even in the EVM’s enforcement phase.

The EVM covers “all assets” of the debtor company, but even if the debtor company operates multiple businesses, it is not allowed to have assets pertaining to only parts of those businesses be the subject of an EVM.³

Only the debtor company of the loans to be secured by the EVM can create the EVM. In other words, no third party can create an EVM over its assets for the benefit of the debtor company.

In order to create an EVM, the debtor company must execute an EVM trust agreement with a trustee that has an EVM trust business license. The agreement designates the trustee as the holder of the EVM, who shall manage and dispose of it as trust assets in accordance with the agreement terms and the Act.⁴

There are two types of beneficiaries under the EVM trust agreement:

Specified secured creditors (tokutei hi-tampo saikensha)	Persons that hold (i) specific claims or (ii) unspecific claims that fall within a certain scope, both as specified in the EVM trust agreement (<i>i.e.</i> , persons that give credit to the debtor company by using an
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² Under the Act, the persons who can create EVMs are limited to companies as defined in the Companies Act – *i.e.*, *kabushiki kaisha*, *goumei kaisha*, *goushi kaisha* and *goudou kaisha*. Entities, partnerships, natural persons, etc. that are not companies under the Companies Act cannot create EVMs.

³ In order to create an EVM over only parts of the assets owned by a company, those assets must be transferred to a separate entity by using a method such as a company split before the EVM is created.

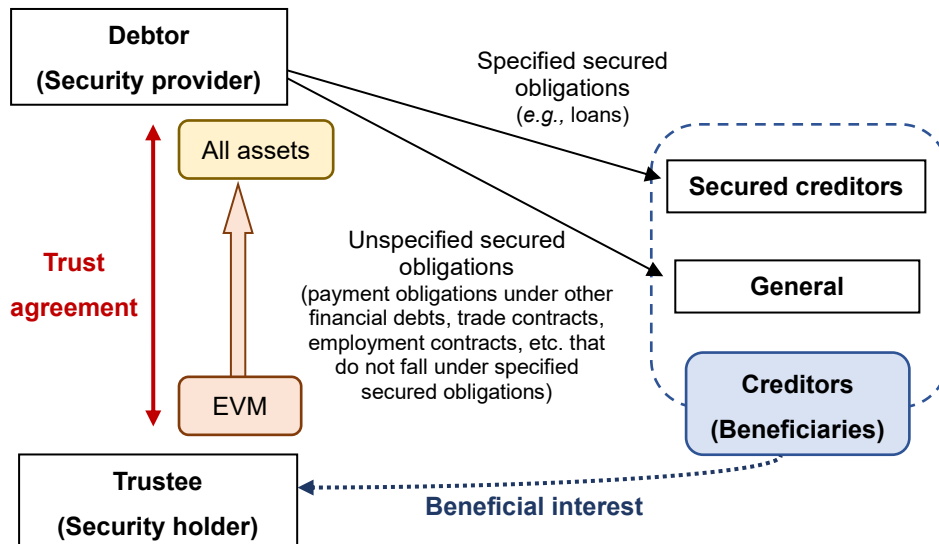
⁴ Under the security trust structure, the EVM itself is not transferred even if a specified secured creditor transfers its secured loans, in which case the transferee of the loans will become a beneficiary of the EVM trust. This makes it relatively easy to assign specified secured loans. For example, if the debtor company’s business conditions deteriorate, the possibility of its business revitalization may be enhanced by smoothly transferring the specified secured loans to a financial institution that has a higher level of competence in business revitalization and takes over the role of support for the debtor company.

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	EVM) ^{5, 6}
Unspecified secured creditors <i>(futokutei hi-tampo saikensha)</i>	General creditors of the debtor company

The basic structure of an EVM is illustrated below.

Basic structure of an EVM



If the EVM is exercised, a certain percentage of the proceeds (the “**Carve-out Amount**”)⁷ will be retained for the benefit of the unspecified secured creditors. The Carve-out Amount is to be allocated to the source of distributions in liquidation or bankruptcy proceedings of the debtor after the completion of the EVM enforcement proceedings.

⁵ If the creditor is licensed to engage in the EVM trust business, it may concurrently act as a specified secured creditor and as the trustee of the EVM.

⁶ The scope of specified secured obligations that may be recovered by the exercise of an EVM is the entire principal, periodical payments including interest, and compensation for damages from defaulting on the obligations (if a maximum secured amount is set as described later, the recoverable amount is limited to the relevant maximum secured amount). In addition, the scope of the specified secured obligations may be changed until the EVM is crystallized.

⁷ The percentage is to be determined under a cabinet order. The higher the percentage, the more protection for general creditors, but the smaller the amount that can be collected by specified secured creditors. The percentage may impact the bankable amount that can be raised by the debtor in loan transactions using the EVM.

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III. Creation and Effect

1. Creation of EVM – Trust Agreement and Registration

As mentioned above, an EVM is created by execution of an EVM trust agreement by and between the debtor and a licensed trustee. Article 8, Paragraph 2 of the Act sets out the matters required to be included in the agreement. In addition, the EVM shall not become effective unless it is registered in the commercial registry of the debtor company.⁸

2. Maximum Secured Amount

The specified secured obligations include those arising from a specific continuous transaction contract and other unspecified payment obligations arising from a certain type of transaction under a certain scope. Therefore, an EVM can be created as a revolving security interest.

Even if an EVM is created as a revolving security interest, unlike a revolving mortgage, the maximum secured amount is not mandatory but is optional at the time of creation of the EVM. However, the debtor may at any time, upon request to the EVM holder (trustee), determine the maximum secured amount of the EVM to be the amount designated by the debtor.⁹

3. Priorities among Conflicting Security Interests

The priorities between EVMs and other security interests are governed as follows:

Other security interest	Determinant of priority
Another EVM (reciprocal)	The timing of registration of creation of the EVMs – whichever is earlier takes priority.
Pledge, real estate mortgage, special statutory lien arising from sale of real	The timing of perfection of the other security interest and the timing of registration of creation of the EVM – whichever is earlier

⁸ As the EVM covers all assets of the debtor company and the effect of its foreclosure is significant, public notice in the commercial registry is required for its effectiveness. The registration tax for creating an EVM will be JPY 30,000.

⁹ The maximum secured amount may not be less than the sum of the amount of specified secured obligations and the unused commitment amount that currently exist (plus interest and commitment fees for two years).

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Other security interest	Determinant of priority
estate	takes priority. However, if the debtor company acquires a property for which such other security interest has already been created, such other security interest takes priority.
General statutory lien, enterprise mortgage ¹⁰	The EVM takes priority.
Special statutory lien (excluding statutory liens on real estate)	The EVM has the same priority as the first ranking lien under Article 330(1) of the Civil Code.
Special statutory lien arising from preservation or construction of real estate	The other security interest (if registered) takes priority.

4. Debtor Company's Authority to Dispose of its Assets

After creating an EVM, the debtor company may still use, profit from and dispose of its assets. However, in order to dispose of any important assets or otherwise use, profit from or dispose of any assets in circumstances where such action goes beyond the ordinary course of business in light of the purpose specified in the debtor company's articles of incorporation and the socially accepted conventions of transactions, the debtor company must obtain the consent of all relevant EVM holders, and any acts conducted without such consent will be void; provided, however, that bona fide third parties without gross negligence will be protected.

5. Protection against Other Creditors

The EVM allows the specified secured creditors to receive distributions from the EVM's enforcement proceeds in preference to other creditors (saving the Carve-out Amount to be retained for the benefit of the unspecified secured creditors). However, if compulsory seizure, exercise of security interest (even that subordinate to the EVM), foreclosure sale, or disposition for collection of national tax delinquency (collectively, "**compulsory seizure, etc.**") is carried out against any assets of the debtor company before the EVM is exercised,

¹⁰ Under the Enterprise Mortgage Act (*kigyuu tampo hou*) (Act No. 106 of 1958), Japanese stock companies (*kabushiki kaisha*) may create enterprise mortgages to secure bonds issued by the company. This type of mortgage is different from EVMs.

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the EVM holder may not receive the dividends or payments in the relevant procedure. This is to avoid closing the door to debt collection by other creditors, considering that the subject of the EVM is the value of the entire business (all assets of the debtor company). For the same reason, the EVM holder cannot file an action against those procedures unless it can demonstrate that they hinder the continuation of the debtor's business.

6. Restrictions on Specified Secured Creditors' Other Remedies

It is assumed in principle that the subject assets of the EVM will be realized through a transfer of the debtor company's entire business. In order to maintain the going concern value of that business, even in cases where a specified secured creditor is granted another security interest (e.g., pledge over certain personal properties, mortgage over real estate) ("**Overlapping Security Interest**") on any individual assets of the same debtor company to secure the same specified secured obligations, exercise of Overlapping Security Interest is prohibited so long as the EVM exists. The EVM must be released if the specified secured creditor wishes to exercise the Overlapping Security Interest. Having said that, Overlapping Security Interest will function as protection against other creditors' compulsory seizure, etc. and compensate for the weak point of the EVM described in Section 5 above.

In addition, as mentioned at the beginning of this newsletter, one of the purposes of the Act is to counteract current lending practices' over-dependence on personal guarantees by the debtor company's proprietor. For this purpose, the specified secured creditor's exercise of its rights under such personal guarantee is prohibited so long as the EVM exists. However, from the viewpoint of preventing window dressing and fraud by the debtor's management and motivating its prudent business operation, the exercise of rights related to personal guarantees is exceptionally permitted even if the EVM exists, for example, where the guarantee agreement provides for a condition precedent for demanding the proprietor's performance of the guarantee that the debtor has made a false report to the creditor in violation of its reporting obligation under the relevant credit agreement.

IV. Trustee

Only those who have obtained a license from the Prime Minister can become

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EVM holders by entering into an EVM trust agreement and being subject to supervision by the Financial Services Agency.¹¹

The following persons are deemed to have obtained such license:

- (i) persons who have obtained a license under Article 3 of the Secured Bond Trust Act (Act No. 52 of 1905)
- (ii) financial institutions licensed under Article 1, Paragraph 1 of the Act on Engagement in Trust Business Activities by Financial Institutions (Act No. 43 of 1943)
- (iii) persons who have obtained a license under Article 3 or 53(1) of the Trust Business Act as amended in its entirety (Act No. 154 of 2004)
- (iv) banks or other persons to be specified by a cabinet order (notification to the Prime Minister is required)

By requiring such license, the Act expects the debtor company to receive appropriate information¹² before creating an EVM. In addition, the Carve-out Amount is expected to be appropriately managed by the licensed trustee during the EVM enforcement proceedings.

On the other hand, the mandatory use of a trust in establishing an EVM and the administrative supervision of the trustee by the government may increase the overall cost of using the EVM. Careful consideration of the details of regulations concerning the trust business should be continued so that such cost increase does not hinder the use of the EVM.

V. Enforcement Proceedings

1. Overview of Enforcement Proceedings

EVMs are generally enforced through the following procedures:

- (i) filing of a petition with the court by the EVM holder (trustee);

¹¹ In contrast, no restrictions are imposed on the persons who may become specified secured creditors. It is expected that a wide range of lenders – not only banks and other financial institutions, but also venture funds and corporation reconstruction funds – will participate in commercial loans utilizing EVMs.

¹² Before a trustee accepts a trust under an EVM trust agreement, it must explain the purpose of the trust and matters related to the trust assets to the debtor company. If the debtor has already received an explanation separately from a certified operator who supports and promotes business cash flow lending, and the debtor has indicated that it does not need to receive further explanation, some of the matters to be explained by the trustee may be omitted.

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- (ii) decision to commence enforcement proceedings and appointment of an administrator (*kanzainin*);
- (iii) business continuation by the administrator;
- (iv) realization by business transfer;
- (v) filing, investigation and determination of claims; and
- (vi) distribution.

Process for Exercising EVMs

A. Commencement of enforcement proceedings	The administrator <u>keeps high enterprise value as much as possible while continuing business operation.</u>	<ul style="list-style-type: none"> (1) The EVM holder may file a petition with the court to enforce the EVM in the event of failure to repay the secured debts. (2) The court appoints an administrator who manages the business of the debtor company. (3) Payment obligations of the debtor that are necessary for continuing its business are performed (e.g., workers' wages).
B. Transfer of business	Under court supervision, the administrator transfers <u>the entire business without dismantling it (in principle).</u>	<ul style="list-style-type: none"> (1) The administrator manages the business and transfers it to a sponsor. (2) Permission from the court is required for the business transfer.
C. Distribution	Lenders recover their loans <u>from proceeds of the business transfer.</u>	<ul style="list-style-type: none"> (1) The secured loans are repaid from the business transfer proceeds. (2) Part of the business transfer proceeds are retained for distribution to general creditors.

(Source: Explanatory material provided by the Financial Services Agency, page 5)

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2. Details of Enforcement Proceedings

(1) Petition to Court by EVM Holder

The enforcement of an EVM is initiated by the first ranking¹³ EVM holder's petition to the competent court for commencement of enforcement proceedings. Such petition can be filed only when the specified secured obligations (excluding the part that becomes a common benefit claim (*kyoueki saiken*)) (the "**Petitioned Claims**") have become due and payable.

(2) Decision to Commence Proceedings and Appointment of Administrator

In response to the petition described in the preceding sub-section, the court will decide to commence the enforcement proceedings if there is evidence of the existence of the Petitioned Claims and the EVM, and of the lapse of the due date of the Petitioned Claims, and if the procedural costs have been prepaid. At the same time, the court appoints an administrator and also decides the periods for filing subordinated claims (*retsugo saiken*)¹⁴ and investigating distributable claims (*haitou saiken*).¹⁵ These periods and the name and other details of the administrator are published in the Official Gazette and separately and individually notified to the petitioner, the administrator, the debtor company, known distributable creditors, etc. (*haitou saikensha-tou*)¹⁶ and the debtor company's labor unions (or a person representing a majority of the workers) and other related parties.¹⁷

An appeal may be filed against a decision to commence the enforcement proceedings. In addition, if a document such as a final judgment proving nonexistence of the EVM is submitted, the enforcement proceedings will be suspended.

¹³ If the EVM is the second or lower priority, its holder cannot file a petition for commencement of enforcement proceedings.

¹⁴ A "subordinated claim" is secured by a subordinated security interest (excluding the part that becomes a common benefit claim) (if the subordinated security interest is an EVM, its specified secured claim becomes the subordinated claim). "Subordinated security interest (*retsugo tanmpoken*)" refers to, among security interests over the debtor's assets that exist at the time of commencement of the EVM enforcement proceedings, those that are subordinate to or have the same priority as the EVM of the petitioner (excluding general statutory liens, enterprise mortgages, rights of retention, and Overlapping Security Interests).

¹⁵ "Distributable claims" refers to the Petitioned Claims, Subordinated Claims and tax claims.

¹⁶ "Distributable creditors, etc." means creditors of distributable claims and EVM holders.

¹⁷ If there are at least 1,000 known distributable creditors, etc., individual notices to them may be omitted by court decision.

FINANCE, RESTRUCTURING & INSOLVENCY NEWSLETTER**(3) Continuation of Business under Management by Administrator**

Upon commencement of the enforcement proceedings, the administrator is entitled to manage the debtor company's business and dispose of its assets, and the business will be continued under management by the administrator. However, the administrator must obtain the court's permission in order to conduct any acts designated by the court as matters requiring such permission. In addition, claims arising from commercial transactions and the like that are necessary for continuing the debtor's business after commencement of the enforcement proceedings are classified as common benefit claims, which can be repaid at any time in preference to distributable claims.

Other major effects of the commencement of enforcement proceedings are as follows:

- (i) Distributable claims can be repaid only in the course of distributions in the enforcement proceedings.
- (ii) Certain restrictions are imposed on set-off. For example, distributable creditors, etc. can set off their payment obligations to the debtor company against their distributable claims, etc. only by the expiration date of the period for filing subordinated claims.
- (iii) In principle, compulsory seizure, etc. already commenced against the debtor's assets will lapse, and no such procedures can be newly commenced.
- (iv) Court proceedings relating to the debtor company's assets are interrupted, and the administrator takes over the proceedings that do not relate to any distributable claims. The administrator has standing as a party in those proceedings.
- (v) Any legal action performed by the debtor with respect to its assets after commencement of the enforcement proceedings shall be void. Even if any rights are acquired without legal action of the administrator or the debtor, such acquisition shall be void. In principle, any registration made after the commencement of enforcement proceedings based on the cause that existed before such commencement shall be null.

On the other hand, even if the enforcement proceedings commence, that does not affect the right to recover properties that do not belong to the debtor,

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and thus such right may be exercised outside the proceedings. Also, a senior security interest (a security interest over the debtor's assets existing when the EVM enforcement proceedings commence that takes priority over the petitioner's EVM, excluding Overlapping Security Interests) may be exercised outside the EVM enforcement proceedings.

(4) Realization by Business Transfer

Realization of the subject assets of the EVM is conducted in principle by way of a transfer of the debtor's business as a whole upon permission of the court. However, if the administrator deems it necessary, individual assets of the debtor may be disposed of upon specific permission of the court. Disposition of assets over which a senior security interest has been created is permitted only if it is clear that all senior security interest holders can be fully repaid.

Prior to permitting a business transfer, the court must hear opinions from known distributable creditors and the debtor company's labor unions (or a person representing a majority of the workers). On the other hand, if the debtor is a stock company (*kabushiki kaisha*), the business transfer conducted with the court's permission does not require the procedures prescribed in the Companies Act, such as resolutions of the shareholders' general meeting and redemption of shares held by dissenting shareholders.

Notably, the transferee of the business may, upon the court's permission, succeed to the governmental approvals and licenses obtained by the debtor unless such succession is prohibited by other laws or regulations.

Security interests other than the EVM that existed over assets realized through the business transfer will be treated as follows:

- (i) Subordinated security interests and Overlapping Security Interests are extinguished.
- (ii) Rights of retention are succeeded to by the transferee, who will then be required to pay the secured obligations.
- (iii) It is possible to apply a different treatment from those described in items (i) and (ii) with the agreement of all interested parties.
- (iv) Senior security interests are expected to be addressed by agreement between the administrator and the senior security holder and, in the

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absence of any specific agreement, are succeeded to by the transferee.

(5) Filing, Investigation and Determination of Claims

In order for a subordinated creditor to participate and receive payment (distributions) in the enforcement proceedings, it must file its claims with the court within the filing period specified at the time of the commencement decision.¹⁸

The subordinated creditor shall report the value of the subject property of the subordinated security interest, or if multiple subordinated creditors have subordinated security interests over the same property, it shall report the highest value from among their reports.

The administrator prepares a statement on whether the administrator approves the details of the distributable claim and the value of the subject property of the subordinated security interest with respect to the Petitioned Claims and each distributable claim filed, and submits the statement to the court. Creditors of the Petitioned Claims and the distributable creditors who filed their claims (collectively, “**filing creditors, etc.**”) may make a written objection to the details of the distributable claim and the value of the subject property of the subordinated security interest within the investigation period specified at the time of the commencement decision.^{19,20}

After the above investigation, the details of the distributable claim and the value of the subject property of the subordinated security interest that the administrator approved and that the filing creditors, etc. did not raise any objection to will be determined based on the value and other details described in the filing. The value of the subject property of the subordinated security interest that is not approved by the administrator or to which any filing creditors, etc. have raised an objection is determined by the lowest value reported by the administrator or the filing creditor, etc., unless a petition for determination of value is filed as described later.

¹⁸ Filing of claims after the expiration of the filing period may be permitted under certain exceptional circumstances.

¹⁹ The debtor company may also raise an objection to the details of the distributable claim. Even if such objection is made, it does not prevent the determination of the distributable claim. However, such objection by the debtor may prevent the electronic statement of distributable creditors from having the same effect as a final and binding judgment after the completion of the enforcement proceedings.

²⁰ In addition to the above investigation, a special investigation period may be provided for distributable claims, etc. that are filed after the expiration of the filing period.

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If the administrator does not approve the details of the distributable claim in the above investigation or any filing creditor, etc. raises an objection, the person who holds that distributable claim may file a petition for assessment of the details only within one month after the last day of the investigation period.²¹ If that distributable creditor is dissatisfied with the decision on this appeal for assessment, it may file an action to oppose within one month after the date of service of such decision. The details of the distributable claim that the administrator does not approve or that any filing creditor, etc. raises an objection to are determined in the above procedures of the petition for assessment and the action to oppose. A court ruling on a petition for assessment or a judgment on an action concerning the determination of a distributable claim is effective against all distributable creditors.

In addition, if the administrator does not approve the value of the subject property of the subordinated security interest in the above investigation or the filing creditor, etc. raises an objection, the subordinated creditor who holds the subordinated security interest may file a petition for valuation within one month after the last day of the investigation period. When such petition for valuation is filed, the court appoints an appraiser to evaluate the subject property and determines its value based on the evaluation. Rulings on petitions for valuation are effective against all distributable creditors, and appeals against such rulings are possible.

The details of the distributable claim and the value of the subject property of the subordinated security interest, which have been determined through the procedures for filing, investigation and determination of the claims, are recorded in the electronic statement of distributable creditors prepared by the court clerk.

(6) Distributions

Once the investigation period has ended and the assets have been realized, the administrator makes the final distributions in accordance with the distributions statement prepared with the court's permission.

²¹ However, if a final judgment is made on a distributable claim, the administrator who did not approve or the filing creditor, etc. who raised an objection must, within one month after the last day of the investigation period, assert an objection in the court proceedings that the debtor can assert. In addition, if a lawsuit with respect to a distributable claim is pending when the EVM enforcement proceedings commence, the relevant distributable creditor cannot file a petition for assessment but must file a petition to take over the lawsuit against the administrator who did not approve and the filing creditor, etc. who raised an objection.

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The distributions are made to distributable claims and unspecified secured claims. The order of priority shall be in accordance with that provided for in the Act as well as other relevant laws such as the Civil Code and the Commercial Code. Distributions to distributable claims with the same priority are made in proportion to the value of those claims. In general, distributions shall be made in the following order:

- (i) For specified secured creditors, distributions are paid up to the amount that is obtained by deducting (a) the sum of (i) the Carve-out Amount and (ii) the total amount of distributions made to persons who can receive them before the EVM holders from (b) the total amount available for all distributions.
- (ii) As for the funds for distributions to unspecified secured creditors, the Carve-out Amount is delivered to the EVM holder.
- (iii) For subordinated creditors, distributions are made up to the value of the subject property of the subordinated security interest based on the assumption that it is the disposal price when the EVM enforcement proceedings commence.²²
- (iv) If there is a surplus after the distributions are made, the administrator delivers it to the debtor.

In lieu of final distributions, the administrator may, by obtaining the court's permission, also make (a) simplified distributions of less than JPY 10,000,000 in total value, or (b) consensual distributions upon the consent of all filed distributable creditors and EVM holders. The administrator may also make interim distributions after the investigation period expires, even before the debtor's assets are realized, and before making final distributions, with the court's permission. In addition, if new properties that can be the source of distribution are discovered, additional distributions will be made.

With respect to employee wages, at least the following amounts are classified as common benefit claims and paid prior to the distributable claims:

- (i) Salaries: the amount equivalent to the salaries for the six months preceding the commencement of the EVM enforcement proceedings;

²² If the value of the subject property of a subordinated security interest is the disposal price when the enforcement proceedings commence, the secured amount becomes the upper limit of distributions to that subordinated claim. Therefore, it is assumed that the value of the subject property of a subordinated security interest to be determined in the filing and investigation of claims will also be the value appraised as the disposal price when the enforcement proceedings commence.

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- (ii) Retirement allowance in the case of retirement before permission is given for making the final distributions: (a) the amount equivalent to the salaries for the six months preceding the retirement; or (b) the amount equivalent to one-third of the retirement allowance, whichever is larger (in the case of periodic payments, the amount equivalent to one-third of those payments); and
- (iii) Deposits: (a) the amount equivalent to the salaries for the six months preceding the commencement of the EVM enforcement proceedings or (b) the amount equivalent to one-third of the deposit, whichever is larger.

(7) Termination of Enforcement Proceedings

The enforcement proceedings shall be terminated by the court's decision to close or discontinue the proceedings.

Closing of the proceedings is decided when the final, simplified or consensual distributions are completed (provided, however, that the proceedings will not be closed if additional distributions are expected). The EVM expires when there is a decision to close the enforcement proceedings.

Discontinuance of the proceedings entails terminating them before the distributions are made under the following circumstances:

- (i) Where it is found that the total value of the subject assets is insufficient to cover the costs of the enforcement proceedings; or
- (ii) Where it is found that the Petitioned Claims can be fully repaid from the subject assets without realizing the assets and that there is no risk of causing disadvantages to any interested persons. In such case, the administrator pays to the specified secured creditors the full amount of their Petitioned Claims.

3. Relationship with Insolvency Proceedings

(1) Treatment of EVM in Insolvency Proceedings

In bankruptcy (*hasan*), rehabilitation (*minji-saisei*), reorganization (*kaishakousei*), special liquidation (*tokubetsu-seisan*) and recognition and assistance proceedings regarding foreign insolvency proceedings (*gaikoku-tousan-tetsuzuki no shounin-enjo*), an EVM is considered as a mortgage. As

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a result, (a) the EVM will be treated as a right that can be separately satisfied (*betsujoken*) in bankruptcy and rehabilitation proceedings, and (b) the claim secured by the EVM will be treated as a secured reorganization claim (*kousei tampoken*) in reorganization proceedings. In addition, the effect of Overlapping Security Interests cannot be asserted in reorganization proceedings.

(2) Treatment of Bankruptcy Proceedings Concurrent with EVM Enforcement Proceedings

Bankruptcy proceedings that are concurrent with EVM enforcement proceedings are to be carried out in parallel, while giving priority to the latter, such as by setting certain restrictions on the powers of the bankruptcy trustee.

First, the right of management and disposition of the administrator in the EVM enforcement proceedings takes precedence over the similar right of the bankruptcy trustee, and the EVM enforcement administrator has the standing to be a party in a lawsuit related to the debtor's assets. In addition, if a bankruptcy trustee has the right to cancel any contract²³ or the right of avoidance, the consent of the EVM enforcement administrator is required in order to exercise those rights.²⁴ If a lawsuit in relation to these matters is pending and the bankruptcy trustee is a party thereto, the EVM enforcement administrator can join as a party.²⁵ Although it is a general rule in bankruptcy law that bankruptcy claims cannot be repaid out of the bankruptcy proceedings, such payments are possible under the EVM enforcement proceedings, which take priority from this viewpoint as well.

In addition, while the EVM enforcement proceedings are pending, certain provisions under the Bankruptcy Act are inapplicable.

On the other hand, if bankruptcy proceedings precede the commencement of the EVM enforcement proceedings, the bankruptcy court may, upon petition by the bankruptcy trustee, decide the period during which the EVM holder may enforce the EVM. Although the EVM holder may file an immediate appeal against such decision of the court, the timing of the EVM enforcement may be restricted to some extent.

²³ More specifically, this refers to the right to cancel a bilateral contract under Article 53, Paragraph 1 of the Bankruptcy Act, the right to cancel a service contract under Article 642, Paragraph 1 of the Civil Code, and the request for cancellation of an employment contract under Article 631 of the Civil Code.

²⁴ However, if the bankruptcy trustee intends to deny the valid creation of an EVM in favor of the petitioner of the EVM enforcement proceedings, the consent of the EVM enforcement administrator is not required.

²⁵ The participation of the EVM enforcement administrator in the lawsuit may effectively restrict the bankruptcy trustee's ability to proceed with the legal activities.

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If the EVM enforcement proceedings precede, the administrator has the right to file a petition for the commencement of bankruptcy proceedings with respect to the debtor company, and furthermore if the debtor is insolvent, the EVM enforcement administrator is obligated to file such petition.

(3) Treatment of Rehabilitation Proceedings Concurrent with EVM Enforcement Proceedings

Rehabilitation proceedings that are concurrent with the EVM enforcement proceedings shall be suspended, and the latter has a higher priority than in the situation described in the preceding sub-section.

The following issues are treated in the same manner as also mentioned above: (a) the preference of the EVM enforcement administrator's right to manage and dispose of the debtor's assets;²⁶ (b) the EVM enforcement administrator's standing to take over the lawsuits relating to the debtor's assets; (c) possibility of payment of rehabilitation claims in the EVM enforcement proceedings; and (d) non-designation of the period for filing of claims in the rehabilitation proceedings.

In addition, although rehabilitation proceedings that are concurrent with the EVM enforcement proceedings are suspended as described above, the following procedures may be proceeded with: (a) procedures concerning a petition for commencement of rehabilitation proceedings; (b) procedures concerning an order to suspend the procedure to enforce a security interest; (c) procedures concerning a right of avoidance that are carried out to deny the creation of an EVM held by a petitioner of the pending EVM enforcement proceedings; (d) procedures concerning a request for permission to extinguish a security interest; (e) procedures concerning discontinuance of rehabilitation proceedings; and (f) procedures concerning the transition from rehabilitation proceedings to bankruptcy proceedings.

(4) Treatment of Reorganization Proceedings Concurrent with EVM Enforcement Proceedings

Reorganization proceedings take precedence over the EVM enforcement proceedings because the secured parties' issues are resolved in the reorganization proceedings and security interests are not allowed to be

²⁶ In rehabilitation proceedings, the main scenario is that no trustee is appointed and the debtor retains the right to dispose of its assets. Even in such case, the EVM enforcement administrator retains the right to dispose of the debtor's assets.

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exercised outside of those proceedings.

First, the right of management and disposition of the reorganization trustee takes precedence over the similar right of the EVM enforcement administrator. In addition, if a petition for commencement of reorganization proceedings is filed, the court may order the suspension of the EVM enforcement proceedings so long as it is deemed necessary, and furthermore if reorganization proceedings are commenced, the EVM enforcement proceedings will be suspended immediately.

If reorganization proceedings commence before the distributions in the EVM enforcement proceedings are completed, subordinated security interests that have been extinguished in the EVM enforcement proceedings are deemed not to have been extinguished in relation to the reorganization proceedings. This is to allow payments to the secured claims that are supposed to be eligible for payment in the reorganization proceedings.

VI. Outlook

The Act will enter into force within two years and six months after its promulgation date, which means the end of 2026 at the latest. By then, relevant cabinet orders and other regulations will have been created.

The Act may have a certain impact on the practice of project financing and LBO financing, which are undertaken on the premise of so-called “total asset security.” It may also provide a way for financing that recognizes the value of assets, even those for which it is impossible or difficult to establish a security interest under the conventional legal framework. There is room for applying the Act to start-up and business revitalization financing as well.

We will continue to monitor the progress of discussions of the Act and relevant regulations and strive to provide further information as needed.

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PUBLICATIONS

- Article "A case in which a business revitalization plan was approved utilizing the Guidelines on Business Revitalization, etc. (revitalization type), which calls for direct debt forgiveness to target creditors in order to maintain the debtor's juridical personality"
Publication The Turnaround & Credit Management No.184
Author Takahiro Ogawa (co-author)
- Article "JAPAN: An Introduction to Capital Markets: Domestic: J-REITs"
Publication Chambers and Partners
Author Taro Omoto, Masahito Saeki, Takahiro Sato and Kana Takeuchi (co-author)
- Article "Chambers Global Practice Guides Real Estate 2024 - Japan Chapter"
Publication Chambers Global Practice Guides Real Estate 2024
Author Eriko Ozawa, Satoru Hasumoto, Takahiro Sato and Fuyuki Uchitsu (co-author)
- Article "The International Insolvency & Restructuring Review 2024/25 – Japan Chapter"
Publication Beaumont Capital Markets
Author Ryo Kawabata, Takashi Harada and Yuichiro Ishida (Co-Author)

NEWS

- **The Best Lawyers in Japan™ and Best Lawyers: Ones to Watch in Japan™ (2025 edition)**

In the 2025 edition of The Best Lawyers in Japan™ by Best Lawyers®, 157 lawyers from our firm have been included in The Best Lawyers in Japan™, and 42 lawyers from our firm have been included in Best Lawyers: Ones to Watch in Japan™.

Best Lawyers

- Banking and Finance Law

Masanori Sato, Hideki Matsui, Akira Marumo, Toshifumi Ueda, Eriko Ozawa, Takahiro Kobayashi, Naoki Ishikawa, Akiko Sueoka, Daisuke Oda, Hiroki Aoyama, Akira Ehira, Shigeki Okatani, Mihoko Shima, Hiroki Kishi, Yoshihito Kuramochi, Yusuke Suehiro, Yusuke Murakami, Kei Shirakawa, Sayako Chujo

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- Structured Finance Law

Masanori Sato, Hideki Matsui, Noboru Suwa, Toshifumi Ueda, Eriko Ozawa, Takahiro Kobayashi, Takeshi Mukawa, Naoki Ishikawa, Hiroki Aoyama, Akira Ehira, Shigeki Okatani, Yusuke Murakami, Satoru Hasumoto

Ones to Watch

- Banking and Finance Law

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We have also become aware of instances of individuals making phone calls and sending emails, fraudulently using the names of the firm's lawyers, to the effect that the recipient is entitled to receive compensation for losses. The firm is not involved in any of these instances.

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