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■ **Restructuring/Insolvency**

Latest Amendments to the Act on Strengthening Industrial Competitiveness in relation to Turnaround ADR

I. <u>Introduction</u>

While the COVID-19 pandemic has caused serious adverse effects on many industries worldwide, the number of corporate bankruptcy cases in Japan in fiscal year 2020 was its lowest in the last 20 years. Support measures implemented by the authorities and financial institutions contributed to the low number of corporate bankruptcies to a certain extent; however, such measures have also resulted in unforeseen side effects as well. As financial institutions have provided COVID-19 support loans aggressively, debtor companies have begun to experience excessive debt problems. At the end of March 2021, the provision for loan losses across 107 major financial institutions was 3.645 trillion yen, up 24.6% from the previous year.[1]

Long-term business deterioration and such excessive debts could lead to a rise in restructuring cases in the near future. Considering that financial debts would comprise the majority of such excessive debts incurred by financial institutions, out-of-court workout procedures like Turnaround Alternative Dispute Resolution ("Turnaround ADR") will likely become increasingly important.

II. <u>Amendment to the Act on Strengthening Industrial Competitiveness</u>

To address various economic and social concerns, including those mentioned above, the Act on Strengthening Industrial Competitiveness (the "Act") was amended in the latest session of the Diet held in June 2021. The amendment contains several initiatives targeting structural change, such as preferential tax treatment for decarbonisation, DX (digital transformation) investment, exceptions to shareholders' meeting requirements to enable entirely virtual meetings, and the facilitation of Turnaround ADR.

The contents of the amendment related to Turnaround ADR include:

(i) <u>Obligating Creditors to make efforts to participate in Turnaround ADR</u>

Although the amendment only obligates creditors to "make efforts to participate in Turnaround ADR", it is significant that such an obligation is

1 *TSR joho*. Issue no. 15465. June 7, 2021

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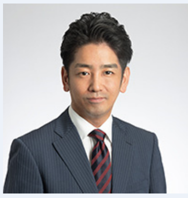

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expressly included in the Act, which will help debtor companies persuade creditors to sit at the Turnaround ADR table.

(ii) Smooth Transition to Simplified Rehabilitation Proceedings

The amendment also seeks to facilitate the smooth transition to Simplified Rehabilitation Proceedings (defined below) in cases where a small number of creditors oppose a proposed business turnaround plan in Turnaround ADR. Specifically, the debtor company may request the Japan Association of Turnaround Professionals[2] (the "JATP") to confirm that the debt forgiveness in the proposed business turnaround plan conforms to the required standards as being essential to the enterprises' turnaround, provided that three-fifths or more of the target creditors (in monetary terms) have consented to the proposed plan. Subsequently, when the debtor company files a petition for the order of Simplified Rehabilitation Proceedings, the court will take the JATP's confirmation into account when it confirms and authorizes the proposed rehabilitation plan identical to the proposed plan in Turnaround ADR.

Simplified Rehabilitation Proceedings are special civil rehabilitation proceedings where a debtor company may shorten its rehabilitation proceedings by omitting the claim determination process in cases where the number of creditors is small or the majority of creditors have given consent to the proposed rehabilitation plan prior to filing a petition ("Simplified Rehabilitation Proceedings").

III. Impact on Future Practices

The incorporation of the majority decision principle into workout processes has been discussed in Japan for several years. However, because the introduction of the majority decision principle in private arrangements would raise constitutional issues in Japan, no firm conclusions have been reached on the feasibility of directly adopting it. The idea of facilitating the smooth transition to Simplified Rehabilitation Proceedings has been discussed as a practical way to adopt the essence of the majority decision principle within Turnaround ADR.

Though the provisions of the amendment related to Turnaround ADR have not yet entered into force and related regulations have not been publicly announced, it is expected that the amendment will have an important effect on Turnaround ADR. Most notably, from a practical perspective, it will accelerate negotiations with opposing creditors in Turnaround ADR by providing a clear pathway to Simplified Rehabilitation Proceedings.

Considering the current uncertain business environment, there may be an increase in the number of instances where minority creditors strongly oppose or do not consent to a proposed business turnaround plan. In these cases, the amendment to the Act will have a direct impact.

2 JATP is the only organization permitted by METI to mediate Turnaround ADR cases.

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■ **Energy**

New Measures to Address Extreme Supply and Demand Pressures and Price Spikes in the Japanese Electricity Wholesale Market

I. Introduction

In December 2020 and January 2021, Japan experienced extreme supply and demand pressures in its electricity market. In order to deal with the situation, Organization for Cross-regional Coordination of Transmission Operators, Japan or OCCTO (a public organization established under the Electricity Business Act) instructed a number of electricity companies to operate their power plants at their maximum level and interchange electricity to the areas experiencing supply pressure. Major gas and oil companies also cooperated with the electricity companies by providing fuel needed to operate thermal power plants. The government additionally requested consumers to be more efficient in their electricity consumption.

This situation also caused a historic price spike in the electricity wholesale market. A new record high of JPY 251.0/kWh was set on January 15, 2021 in the spot market of the Japan Electric Power Exchange ("JEPX"). As a comparison, the average prices of JEPX spot markets from 2016 to 2019 were between JPY 8/kWh to JPY 10/kWh. This price spike further triggered a high imbalance fee, which is imposed on electricity retailers when they do not procure sufficient electricity to supply their consumers.[3] The high imbalance fee in turn caused a financial crisis for a number of electricity retailers. While the government provided some financial support, such as requesting electricity utilities to allow the imbalance fee to be paid in installments, some electricity retailers have now been forced to commence bankruptcy procedures.

II. Reasons and Contributing Factors

According to a government assessment, the main reasons for this serious state of affairs were a combination of severe cold weather (demand-side) and LNG shortage (supply-side). In spite of the forecast announced by the Japan Meteorological Agency in September 2020, a strong cold front hit Japan and caused a significant increase in the demand for electricity. The LNG shortage was caused by accidents occurring at LNG production plants in LNG producing countries, which limited the electricity generation at domestic LNG power plants. Since LNG is by nature hard to store for the long term as well as procure flexibly, the domestic LNG power plants had difficulty overcoming the supply shortage in a short period of time once a certain amount of LNG supply had ceased.

The government also stated that the growing dependence on LNG power plants was a contributing factor. In the past five years, many oil power plants were decommissioned due to their age, economic inefficiency and environmental load. The government assessment also cited the following as contributing factors: (i) the suspension of many nuclear power plants due to tighter regulations, regular inspections and judicial injunctions; (ii) fluctuating supply due to the expansion of photovoltaic and wind power; and (iii) a number of large coal power plants being offline during the period between 2020 year-end and January 2021.

III. New Measures

Learning from these lessons, the government is planning to introduce three types of measures to prevent a similar situation from occurring in the future: preventive measures, contingency measures and structural measures.

- Preventive measures: The government will improve and extend the governmental forecast of supply and demand conditions. Also, the government will prepare a guideline to demonstrate good practices among electricity generators in relation to fuel procurement and will promote hedge trading through the forward market[4], base-load market[5] and futures market.[6]

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3 Under the current regulations the imbalance fee is determined by the JEPX price.

4 "Forward market trading" is currently available in JEPX and is the trading of electricity supplied for a certain period (one week, one month or one year) starting on a day that is three or more days from the trade date. Orders are continuously executed in strict price and time priority. For example, an order entered into the system at an earlier time must be executed in full before an order entered at a later time at the same price is executed.

5 The "base-load market" is a relatively new market in JEPX operating since July 2019. This is a wholesale forward market of electricity generated by a nuclear power plant, a traditional large-scale hydro power plant, a coal-fired power plant or a geothermal power plant ("base-load electricity") to electricity retailers. Major electricity utilities are required to offer base-load electricity to the base-load market for a prescribed price to secure electricity retailers' access to base-load electricity. That price is intended to be not unduly higher than the utilities' intra-group price.

6 The "futures market" was first established by the Tokyo Commodity Exchange, Inc ("TOCOM") in September 2019 and allows buyers to hedge the volatility risk of the JEPX spot market trading price. The European Energy Exchange ("EEX") and New York Mercantile

- Contingency measures: The government will prepare a framework for the relevant parties (i.e., electricity companies, OCCTO and the government) on how to manage extreme supply and demand pressures in order to systematize the steps to be taken and communication lines in an emergency situation.

  The government also plans to make changes to the imbalance fee rules. In January 2021 the government set JPY 200/kWh as a ceiling price on the imbalance fee, which functioned as a price limit in the JEPX market.[7] Additionally, the government has also announced that from July 1, 2021, the imbalance fee will be restructured into a two-tier regime where the ceiling price will be set at either JPY 80/kWh or JPY 200/kWh in normal conditions or emergency conditions, respectively. Furthermore, after 2022 the calculation of the imbalance fee will be linked to the real-time market instead of the JEPX market.[8]

- Structural measures: The government will improve the predictability of power plant investments by reforming the capacity market[9] to promote the construction of new power plants and maximize the existing power grid network. The government also plans to prepare risk management guidelines that outline basic risk assessment methodology and good risk management practices in the electricity retail and generation businesses.

IV. Comment

Through this experience, electricity retailers have been forced to acknowledge the importance of risk management in the electricity retail business. In addition to reviewing existing power purchase agreements and the general terms and conditions of their electricity supply, electricity retailers are expected to expand bilateral procurement contracts, secure their own electricity generation (either through establishing new generation or by acquisition) and engage in hedge trading in order to manage the volatility risk of the electricity wholesale market. According to OCCTO's assessment, it is anticipated that Japan will again experience extreme electricity supply and demand pressures in both summer and winter 2021. As such, electricity retailers currently find themselves needing to act fast to avoid a repeat of the volatility seen in winter 2020.

Exchange ("NYMEX") also launched a Japanese futures market in May 2020 and February 2021, respectively.

7 This is because the imbalance fee is charged when electricity retailers do not procure sufficient electricity in the JEPX market.

8 A "real-time market" (also referred to as a balancing market) administered by the Transmission and Distribution Grid Council commenced operation in 2021. Through this market, electricity utilities are able to procure fuel reserves by auction in order to maintain control over the supply frequency in their region.

9 The "capacity market" held its first auction in July 2020. While electricity companies trade in kWh in the JEPX market, the capacity market auctions the future value of generation capacity in kW. The capacity market is expected to provide predictability to recover certain fixed costs in the generation business where such fixed costs have been difficult to recover due to the liberalization of the retail sector. These are often referred to as "stranded costs". If a generator places a successful bid at a capacity market auction it may receive a certain amount of fixed income from OCCTO for four years after the auction, which will be funded by a capacity surcharge that OCCTO levies from electricity retailers.

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