

Japan Airlines Encounters Turbulence

In January 2010 Japan Airlines (JAL) filed for bankruptcy under the Japanese Corporate Reorganization Act, leaving debts of \$28 billion. It was one of Japan's biggest-ever corporate failures. In a corporate reorganization a judge appoints a trustee, who is expected to weigh the rights and interests of various stakeholders, including employees. Typically, this trustee is a bankruptcy lawyer, whose initial task is to remove existing management and take control of the company.¹

Only three months before JAL's bankruptcy the Enterprise Turnaround Initiative Corporation of Japan (ETIC) was established to help firms that are potentially profitable but that are hampered by excessive debt. ETIC was empowered to negotiate agreements with a firm's creditors, buy debts from creditors, and make loans. When JAL filed for bankruptcy, ETIC was appointed by the court as a trustee to devise a restructuring plan.²

ETIC's plan involved drastic cuts in operations; the airline was required to ditch unprofitable routes, cut a third of its work force, and slash pension benefits. Shareholders would be wiped out and unsecured creditors forced to write off over 80 percent of their claims. Under the turnaround plan, ETIC and the Development Bank of Japan agreed to provide over \$6 billion of new financing to keep the airline flying.

JAL's rehabilitation plan was approved by the Tokyo District Court in November 2010. The court's approval cleared the way for a capital injection of \$4.2 billion from the state-backed Enterprise Turnaround Initiative Corp. In March 2011 the company emerged from bankruptcy, having paid off its creditors and secured more than \$3 billion in new loans and capital. A year later it was operating profitably, and in September 2012 it went public again in an \$8.5 billion IPO.

¹ In 2000 the Japanese government enacted an alternative to corporate reorganization, known as Civil Rehabilitation. This provides for management to retain control. Civil rehabilitation is popular with managers who want to keep their jobs, but it also has drawbacks. In particular, a debtor company lacks protection against secured creditors, who can move to regain control of assets that serve as collateral for loans.

² A veteran bankruptcy lawyer was appointed as co-trustee to supervise legal proceedings.