Global Restructuring and Insolvency Guide - Japan

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# Initial Considerations

## Can you take security over all types of assets, including accounts receivable?

Before the commencement of the proceedings, security can be taken over any type of assets, including accounts receivable. Available forms of security vary depending on the types of the subject assets (e.g., mortgage or pledge over real properties, pledge or security transfer (joto-tanpo) over receivables, shares in a company or movables).

## What is the nature of the insolvency process?

**Bankruptcy**

Court-supervised proceedings liquidate an insolvent debtor and make distributions (if any) to creditors to satisfy existing debts

The court appoints the bankruptcy trustee and administers the case under the court's supervision.

Secured creditors may enforce their security interests outside of the proceedings.

**Civil rehabilitation**

Court-supervised proceedings reorganize a debtor pursuant to a rehabilitation plan.

The debtor's existing management continues to operate the debtor's business (i.e., debtor-in-possession type proceedings) under the supervision of the court and the supervisor appointed by the court. The trustee is appointed only in special circumstances.

A rehabilitation plan needs to be accepted by the creditors and confirmed by the court.

Secured creditors may enforce their security interests outside of the proceedings.

**Corporate reorganization**

Court-supervised proceedings reorganize a debtor's business pursuant to a reorganization plan. It is available only for stock corporations.

The court appoints the trustee and administers the case under the court's supervision.

A reorganization plan needs to be accepted by the creditors (and, in certain situations, shareholders) and confirmed by the court.

Both unsecured and secured creditors are subject to the proceedings and may be paid only pursuant to the plan.

**Special liquidation**

Liquidation proceedings are designed for special cases where there are circumstances that seriously hinder the implementation of the liquidation or a debtor is suspected to be in a state of insolvency. It is available only for stock corporations already in the process of an ordinary liquidation.

The liquidator (usually from the existing management of the debtor or a qualified lawyer) is appointed by the shareholders' meeting of the debtor and administers the case under the court's supervision.

The liquidator liquidates the debtor pursuant to an agreement approved by the creditors and confirmed by the court.

Secured creditors may enforce their security interests outside of the proceedings.

## What is the solvency requirement for a company to file a case in this jurisdiction?

**Bankruptcy**

Available for the debtor in either of these insolvencies:

Balance sheet insolvency (this being the case where the debtor has a net worth deficit); or

Cash flow insolvency (this being the case where the debtor is generally and continuously unable to pay its debts as they fall due)

In this section, the word "bankruptcy" means balance sheet insolvency and cash flow insolvency.

The debtor's external statement will rebuttably presume cash flow insolvency (whether express or implied, such as by doing a flit or dishonoring a bill)) that the debtor is generally and continuously unable to pay its debts as they fall due.

**Civil rehabilitation**

Available for the debtor that is either of the following:

Is at risk of bankruptcy

Is unable to pay debts as they fall due without significantly impairing the debtor's business operations

**Corporate reorganization**

Available for the debtor that is either of the following:

Is at risk of bankruptcy

Is unable to pay debts as they fall due without significantly impairing the debtor's business operations

**Special liquidation**

Available in either of the following if:

There are circumstances that seriously hinder the implementation of the liquidation of the debtor.

The debtor is suspected to be in a state of balance sheet insolvency.

## Is there a requirement to demonstrate COMI ("centre of main interests") for a company to file a case in this country?

**Bankruptcy**

No. However, the debtor needs to have an office or property in Japan in order to file a petition for the proceedings.

**Civil rehabilitation**

No. However, the debtor needs to have an office or property in Japan in order to file a petition for the proceedings.

**Corporate reorganization**

No. However, the debtor needs to have a business office in Japan in order to file a petition for the proceedings. In addition, this process is available only for debtors that are stock corporations.

**Special liquidation**

No. However, this process is available only for debtors that are stock corporations.

## Is restructuring of both secured and unsecured claims possible?

**Bankruptcy**

No. This process deals only with unsecured claims (including the unsecured portion of secured claims).

**Civil rehabilitation**

No. This process deals only with unsecured claims (including the unsecured portion of secured claims).

**Corporate reorganization**

Yes. This process deals with both secured and unsecured claims.

**Special liquidation**

No. This process deals only with unsecured claims (including the unsecured portion of secured claims).

## Are the claims of creditors and shareholders put into separate classes for purposes of voting and treatment under the plan or scheme?

No

## Is shareholder approval needed to commence a case? Are shareholders entitled to vote on a plan?

**Bankruptcy**

No. Shareholder approval is not required to commence a case.

N/A. A plan is not formulated in the bankruptcy proceedings.

**Civil rehabilitation**

No. Shareholder approval is not required to commence a case.

No. Shareholders are not entitled to vote on a plan.

**Corporate reorganization**

No. Shareholder approval is not required to commence a case.

Yes. Shareholders are entitled to vote on a plan. However, if the debtor is in a state of balance sheet insolvency at the time an order commencing reorganization proceedings is issued, no shareholder has the voting right.

**Special liquidation**

Special liquidation is available only for stock corporations in the ordinary liquidation proceedings. Consent of shareholders who hold two-thirds or more of the total voting rights is required (unless a higher voting requirement is provided in the debtor's articles of incorporation) to initiate the ordinary liquidation proceedings.

No. Shareholders are not entitled to vote on an agreement with creditors.

## Is there an ability to bind minority dissenting creditors (i.e., cramdown)?

**Bankruptcy**

N/A. Voting approvals are not required.

**Civil rehabilitation**

Yes

**Corporate reorganization**

Yes

**Special liquidation**

Yes

# Commencing the Process

## Who can commence?

**Bankruptcy**

The process is commenced by a petition of (1) the debtor, (2) any prepetition unsecured creditors (i.e., bankruptcy creditors), (3) any director or equivalent or (4) a liquidator (if the debtor is a liquidating company).

**Civil rehabilitation**

The process is commenced by a petition of (1) the debtor or (2) any prepetition unsecured creditors (i.e., rehabilitation creditors) (only where the debtor has the risk of bankruptcy).

**Corporate reorganization**

The process is commenced by a petition of (1) the debtor, (2) any creditor(s) with an aggregate amount of claims that is at least 10% of the debtor's stated capital or (3) any shareholder(s) holding at least 10% of the total voting rights — provided, (2) and (3) is applicable only where the debtor faces the risk of bankruptcy.

**Special liquidation**

The process is commenced by application of (1) any creditor, (2) a liquidator, (3) a statutory auditor and (4) a shareholder. A liquidator is obliged to file a petition for special liquidation if the debtor is suspected to be in a state of balance sheet insolvency.

## Is shareholder's consent required to commence proceeding?

**Bankruptcy**

No

**Civil rehabilitation**

No

**Corporate reorganization**

No

**Special liquidation**

Consent of shareholders who hold two-thirds or more of the total voting rights (unless a higher voting requirement is provided in the debtor's articles of incorporation) is required to dissolve the debtor and initiate the ordinary liquidation proceedings, which need to precede the special liquidation proceedings.

## Is there an ability to consolidate group estates?

No. The proceedings for group companies may be jointly administered and coordinated by a single court, but Japanese laws respect legal entities and do not recognize the concept of group estates or substantive consolidation.

## Is there any court involvement?

**Bankruptcy**

Yes, the court supervises the process. Certain matters/conducts require the court's prior approval.

**Civil rehabilitation**

Yes, the court supervises the process. Certain matters/conducts require the court's prior approval or the supervisor appointed by the court. The court reviews and confirms the rehabilitation plan if all of the requirements are satisfied.

**Corporate reorganization**

Yes, the court supervises the process. Certain matters/conducts require the court's prior approval. The court reviews and confirms the reorganization plan if all of the requirements are satisfied.

**Special liquidation**

Yes, the court supervises the process. Certain matters/conducts require the court's prior approval. The court reviews and confirms the agreement with creditors if all of the requirements are satisfied.

## Who manages the debtor?

**Bankruptcy**

The bankruptcy trustee appointed by the court.

**Civil rehabilitation**

The existing management of the debtor (i.e., debtor-in-possession) generally retains the power to manage the debtor's business and other affairs. In rare cases where the court finds the debtor's management inappropriate, the court may appoint the trustee to replace the existing management of the debtor.

**Corporate reorganization**

The reorganization trustee appointed by the court. The reorganization trustee is usually a qualified third-party lawyer. However, the court may appoint a former member of management as the trustee, as long as this person was not responsible for the potential damage claims that might be pursued for any business failure caused by the debtor's management.

**Special liquidation**

The special liquidator (usually a former member of the management of the debtor or a qualified lawyer) appointed by the shareholders' meeting of the debtor.

## What is level of disclosure of process to voting creditors?

**Bankruptcy**

N/A. Voting approvals by creditors are not required. However, the trustee discloses to the creditors certain information on the debtor and the proceedings at creditors' meetings.

**Civil rehabilitation**

Creditors' meetings (including voluntary explanatory sessions) are held to provide creditors with certain information on the debtor and the proceedings.

When the court has decided to submit a rehabilitation plan to the creditors' meeting for their approval, the plan and relevant information are provided to creditors sufficiently before the creditors' meeting to vote on the plan.

**Corporate reorganization**

Stakeholders' meetings (including voluntary explanatory sessions) are held to provide stakeholders with certain information on the debtor and the proceedings.

When the court has decided to submit a reorganization plan to the stakeholders' meeting for their approval, the plan and relevant information are provided to stakeholders sufficiently in advance of the stakeholders' meeting for voting on the plan.

**Special liquidation**

Creditors' meetings (including voluntary explanatory sessions) are held to provide creditors with certain information on the debtor and the proceedings.

A draft agreement with creditors and relevant information is provided to creditors sufficiently in advance of the creditors' meeting for voting.

## What entities are excluded from customary insolvency or reorganisation proceedings, and what legislation applies to them?

**Bankruptcy**

No entity (except for national and local governments) is generally excluded from the process. Financial institutions may be subject to special rules.

**Civil rehabilitation**

No entity (except for national and local governments) is generally excluded from the process. Financial institutions may be subject to special rules.

**Corporate reorganization**

This process is only available for stock corporations. Financial institutions (which are stock corporations) are subject to special rules set out in the Act on Special Measures for the Reorganization Proceedings of Financial Institutions.

**Special liquidation**

This process is only available for stock corporations. Financial institutions may be subject to special rules.

## How long does it generally take for a creditor to commence the procedure?

This varies depending on the circumstances (e.g., whether and to what extent the creditor may prove the requirements of commencement of the cases and the debtor challenges the petition), but it usually takes considerably longer than voluntary insolvency cases (e.g., from one month to six months or longer).

# Effect of Process

## Does debtor remain in possession with continuation of incumbent management control?

**Bankruptcy**

No. The debtor loses its management control, which passes to the trustee upon the commencement of the process.

**Civil rehabilitation**

Generally yes. The debtor remains in possession with management control, subject to the supervision by the court or the supervisor appointed by the court, unless the court appoints the trustee in special circumstances.

**Corporate reorganization**

Generally no. The debtor loses its management control, which passes to the trustee upon the commencement of the process. However, under certain circumstances, the court may appoint a former member of management as the trustee.

**Special liquidation**

Generally no. However, the liquidator, appointed by the debtor's shareholders' meeting, who may be a former member of the debtor's management, takes control of the debtor.

## What is the stay/moratorium regime (if any)? Is the stay or moratorium worldwide?

**Bankruptcy**

Upon the commencement of the process, unsecured creditors are automatically stayed from enforcing any pre-commencement claims against the debtor, while secured creditors are not prohibited from enforcing their security rights.

In addition, during the period from the filing of the petition to the commencement of the process, the court may grant an order staying pending prepetition enforcement actions against the debtor or prohibiting making any enforcement actions against the debtor, except for the enforcement of security interests.

Generally, the effect of Japanese insolvency proceedings is worldwide. However, in order to stay legal proceedings such as litigation and compulsory execution pending in other jurisdictions, it is necessary to obtain recognition and assistance orders to that effect from the court in such jurisdictions.

**Civil rehabilitation**

Upon the commencement of the process, unsecured creditors are automatically stayed from enforcing any pre-commencement claims against the debtor, while secured creditors are not prohibited from enforcing their security rights.

In addition, during the period from the filing of the petition to the commencement of the process, the court may grant an order staying pending prepetition enforcement actions against the debtor or prohibiting making any enforcement actions against the debtor, except for the enforcement of security interests.

Generally, the effect of Japanese insolvency proceedings is worldwide. However, in order to stay legal proceedings such as litigation and compulsory execution pending in other jurisdictions, it is necessary to obtain recognition and assistance orders to that effect from the court in such jurisdictions.

**Corporate reorganization**

Upon the commencement of the process, both the unsecured creditors and secured creditors are automatically stayed from enforcing any pre-commencement claims or security interests against the debtor.

In addition, during the period from the filing of the petition to the commencement of the process, the court may grant an order staying pending prepetition enforcement actions against the debtor or prohibiting making any enforcement actions against the debtor, including enforcement of security interests.

Generally, the effect of Japanese insolvency proceedings is worldwide. However, in order to stay legal proceedings such as litigation and compulsory execution pending in other jurisdictions, it is necessary to obtain recognition and assistance orders to that effect from the court in such jurisdictions.

**Special liquidation**

Upon the commencement of the process, general unsecured creditors are automatically stayed from enforcing any pre-commencement claims against the debtor outside the process, while secured creditors are not prohibited from enforcing their security rights and prioritized creditors are not prohibited from enforcing their claims.

In addition, during the period from the filing of the petition to the commencement of the process, the court may grant an order staying pending prepetition enforcement actions against the debtor or prohibiting making any enforcement actions against the debtor, except for the enforcement of security interests and prioritized claims.

Generally, the effect of Japanese insolvency proceedings is worldwide. However, in order to stay legal proceedings such as litigation and compulsory execution pending in other jurisdictions, it is necessary to obtain recognition and assistance orders to that effect from the court in such jurisdictions.

## Is there a provision for debtor in possession or rescuer financing or superpriority or priming financing?

**Bankruptcy**

No

**Civil rehabilitation**

No. Post-petition DIP loans could be entitled to administrative expense status ("common benefit claims"), which has priority over other claims but does not prioritize different types of administrative expense claims.

**Corporate reorganization**

No. Post-petition DIP loans could be entitled to administrative expense status ("common benefit claims"), which has priority over other claims but does not prioritize different types of administrative expense claims.

**Special liquidation**

No

## Can procedure be used to implement a debt-to-equity swap?

**Bankruptcy**

No

**Civil rehabilitation**

Yes, a rehabilitation plan may provide a debt-to-equity swap arrangement.

**Corporate reorganization**

Yes, a reorganization plan may provide a debt-to-equity swap arrangement.

**Special liquidation**

No

## Are third party releases available?

No.

## Are the proceedings recognised abroad?

Yes, subject to the domestically adopted version of the UNCITRAL Model Law, other applicable conflicts of laws principles or treaties in other jurisdictions.

## Has the UNCITRAL Model Law been adopted?

Yes. The Law on Recognition of and Assistance for Foreign Insolvency Proceedings ("**Recognition and Assistance Law**") is largely modeled on the UNCITRAL Model Law. However, there are some differences between the Recognition and Assistance Law and the UNCITRAL Model Law, including the following:

Under the Recognition and Assistance Law, the recognition order is issued when the foreign court makes a decision to commence the proceedings or the foreign proceedings have an effect equivalent thereto. As such, in the case of interim proceedings or other proceedings before the commencement of foreign proceedings, a debtor needs to apply for a separate assistance procedure that has the effect of staying each existing procedure individually rather than of a comprehensive stay.

The Recognition and Assistance Law requires the court to issue an order to cancel recognition of foreign insolvency proceedings when the foreign insolvency proceedings are closed with a decision equivalent to an order to complete bankruptcy proceedings, an order to confirm rehabilitation plan, an order to confirm reorganization plan or an order to close special liquidation has been issued. In practice, in the case of recognition of foreign rehabilitation or reorganization proceedings, the court may cancel the recognition when the foreign court issues an order to confirm the rehabilitation plan or an order to confirm the reorganization plan.

## Can a debtor continue to carry on business during insolvency proceedings?

**Bankruptcy**

Generally no. As an exception, a debtor can continue to carry on the business with the court's permission.

**Civil rehabilitation**

Yes. A debtor can carry on business throughout the process.

**Corporate reorganization**

The trustee can carry on the debtor's business throughout the process.

**Special liquidation**

No.

# Other Factors

## Are there any wrongful or insolvent trading restrictions and what is the directors' liability?

In general, there are no insolvency trading restrictions and the directors of the debtor do not owe any obligation to file insolvency proceedings. However, the directors may be subject to civil liability to the company (if such involvement amounts to a breach of the duty of care owed to the company) and/or third parties who incur damage as a result of the directors' misconduct (if the damage is caused by the directors' willful intent or gross negligence). In addition, each of these proceedings has a special summary procedure in which the trustee or the supervisor may seek the personal liability of the debtor's directors.

## What is the order of priority of claims?

**Bankruptcy**

The order of priority of claims is as follows:

secured claims (i.e., secured creditors can generally enforce their security outside the process)

administrative expense claims (zaidan saiken), which may be satisfied from the bankruptcy estate in priority to other unsecured claims

priority unsecured claims (i.e., unsecured claims that are given statutory priority, such as statutory liens), which may be satisfied from the bankruptcy estate in priority to general unsecured claims

general unsecured claims

subordinated claims (e.g., interest that accrues post-commencement of the process)

**Civil rehabilitation**

The order of priority of claims is as follows:

secured claims (i.e., secured creditors can generally enforce their security outside the process)

administrative expense claims (kyoeki saiken), which may be satisfied in full as they fall due outside the rehabilitation plan

priority unsecured claims (i.e., unsecured claims that are given statutory priority, such as statutory liens), which may be satisfied in full as they fall due outside the rehabilitation plan

general unsecured claims, which may be satisfied only pursuant to the rehabilitation plan

subordinated claims, which may be satisfied only pursuant to the rehabilitation plan

**Corporate reorganization**

The order of priority of claims is as follows:

administrative expense claims (kyoeki saiken), which may be satisfied in full as they fall due outside the reorganization plan

secured claims, which may be satisfied to the extent of the value of collateral only pursuant to the reorganization plan

priority unsecured claims (i.e., unsecured claims that are given statutory priority, such as statutory liens), which may be satisfied only pursuant to the reorganization plan

general unsecured claims, which may be satisfied only pursuant to the reorganization plan

subordinated claims, which may be satisfied only pursuant to the rehabilitation plan

**Special liquidation**

The order of priority of claims is as follows:

secured claims (i.e., secured creditors can generally enforce their security outside the process)

claims relating to administrative expenses and claims that are given statutory priority (such as statutory liens), which may be satisfied in full as they fall due outside the repayment agreement

other unsecured claims, which are subject to a pro-rata distribution from the remaining funds pursuant to an agreement with creditors after the payments to claims 1 and 2

## Do pension liabilities have any priority over other unsecured claims?

**Bankruptcy**

Pension liabilities under public pension plans are treated as the priority unsecured claims and have priority over the general unsecured claims.

In contrast, pension liabilities under corporate pension plans such as DC and DB are treated as general unsecured claims.

**Civil rehabilitation**

Pension liabilities under public pension plans are treated as the priority unsecured claims and have priority over the general unsecured claims.

In contrast, pension liabilities under corporate pension plans such as DC and DB are treated as general unsecured claims.

**Corporate reorganization**

Pension liabilities under public pension plans are treated as the priority unsecured claims and have priority over the general unsecured claims.

In contrast, pension liabilities under corporate pension plans such as DC and DB are treated as general unsecured claims.

**Special liquidation**

Pension liabilities under public pension plans are given statutory priority, which may be satisfied in full as they fall due outside the repayment agreement.

In contrast, pension liabilities under corporate pension plans such as DC and DB are treated as unsecured claims subject to a pro-rata distribution in accordance with the repayment agreement.

## Is it possible to challenge prior transactions?

**Bankruptcy**

Yes. The trustee or the supervisor may seek several types of avoidance actions, including the following. The avoidance actions must be sought within the earlier of two years from the date of commencement of the case or 20 years from the date when the transaction was entered into.

**Preferences**

Upon commencement of insolvency proceedings, the following acts are voidable as a preference:

the debtor paid an existing claim or collateralized its assets to secure an existing claim, after the debtor became unable to pay debts or filed for any of insolvency proceedings, and the creditor was aware of the occurrence of the substantial insolvency event

the debtor paid an existing claim or collateralized its assets to secure an existing claim within 30 days before the debtor became unable to pay debts, despite the fact that the debtor was not obligated to do so (except where the beneficiary was unaware that such payment or collateralization harmed other creditors)

**Fraudulent transfers**

Upon commencement of insolvency proceedings, the following acts (except for collateralizing assets and paying existing claims) are voidable as a fraudulent transfer:

the debtor and the beneficiary entered into a transaction with knowledge that the transaction harmed the interests of other creditors

after the suspension of payments or filing for any insolvency proceedings (collectively "**Suspension of Payments**"), the debtor entered into a transaction that harmed the interests of creditors and the beneficiary was aware of both the occurrence of the Suspension of Payments and the fact that the transaction harmed the creditors

after or within six months prior to the Suspension of Payments, the debtor and the beneficiary entered into a transaction in which the debtor received no or substantially no consideration

**Civil rehabilitation**

Yes. The trustee or the supervisor may seek several types of avoidance actions, including the following. The avoidance actions must be sought within the earlier of two years from the date of commencement of the case or 20 years from the date when the transaction was entered into.

**Preferences**

Upon commencement of insolvency proceedings, the following acts are voidable as a preference:

the debtor paid an existing claim or collateralized its assets to secure an existing claim, after the debtor became unable to pay debts or filed for any of insolvency proceedings, and the creditor was aware of the occurrence of the substantial insolvency event

the debtor paid an existing claim or collateralized its assets to secure an existing claim within 30 days before the debtor became unable to pay debts, despite the fact that the debtor was not obligated to do so (except where the beneficiary was unaware that such payment or collateralization harmed other creditors)

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after the suspension of payments or filing for any insolvency proceedings (collectively "**Suspension of Payments**"), the debtor entered into a transaction that harmed the interests of creditors and the beneficiary was aware of both the occurrence of the Suspension of Payments and the fact that the transaction harmed the creditors

after or within six months prior to the Suspension of Payments, the debtor and the beneficiary entered into a transaction in which the debtor received no or substantially no consideration

**Corporate reorganization**

Yes. The trustee or the supervisor may seek several types of avoidance actions, including the following. The avoidance actions must be sought within the earlier of two years from the date of commencement of the case or 20 years from the date when the transaction was entered into.

**Preferences**

Upon commencement of insolvency proceedings, the following acts are voidable as a preference:

the debtor paid an existing claim or collateralized its assets to secure an existing claim, after the debtor became unable to pay debts or filed for any of insolvency proceedings, and the creditor was aware of the occurrence of the substantial insolvency event

the debtor paid an existing claim or collateralized its assets to secure an existing claim within 30 days before the debtor became unable to pay debts, despite the fact that the debtor was not obligated to do so (except where the beneficiary was unaware that such payment or collateralization harmed other creditors)

**Fraudulent transfers**

Upon commencement of insolvency proceedings, the following acts (except for collateralizing assets and paying existing claims) are voidable as a fraudulent transfer:

the debtor and the beneficiary entered into a transaction with knowledge that the transaction harmed the interests of other creditors

after the suspension of payments or filing for any insolvency proceedings (collectively "**Suspension of Payments**"), the debtor entered into a transaction that harmed the interests of creditors and the beneficiary was aware of both the occurrence of the Suspension of Payments and the fact that the transaction harmed the creditors

after or within six months prior to the Suspension of Payments, the debtor and the beneficiary entered into a transaction in which the debtor received no or substantially no consideration

**Special liquidation**

Avoidance actions are not available in the special liquidation. However, similar mechanisms exist under the Civil Code for a creditor to seek cancellation of certain transactions that are detrimental to the creditors.

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