

JAPAN

Be prepared for bankruptcy risk in technology transactions

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It is not rare that a company be faced with trading partner's bankruptcy. While many companies that have a monetary claim against the trading partner would perform credit management in preparation for the partner's bankruptcy, only a few companies which have a claim not intended for monetary payment would take such a step. However, where a company has been provided with technology by a trading partner, it is likely that that company incurs greater loss than a company only having a monetary claim when the trading partner went bankrupt. For example, such a company will be unable to be provided technology from the trading partner or may be obligated to pay a large penalty to a third party as the following case shows.

Negotiation with a trading partner that went bankrupt

Company X, which has provided semiconductor manufacturing equipments, purchased a device manufactured by company Y, assembled the device into X's product and sold the product to Chinese company Z. The device drawings were indispensable to the maintenance of the device. It was agreed that Y, which possesses the device drawings, had a duty to perform maintenance of the device free of cost.

It became clear that the device had a malfunction after X sold the product to Z. X urged Y to repair the device. However Y filed a petition for commencement of bankruptcy proceedings, which is provided in the Bankruptcy Act and is for proper and fair liquidation of property held by debtors who are unable to pay debts or insolvent, and the court began bankruptcy proceedings. At the same time that bankruptcy proceedings started, the court appointed a bank-

ruptcy trustee in which the right to administer and dispose of property that belongs to the bankruptcy estate will be vested exclusively. Therefore, X could not expect Y to repair the device.

If the device remains unrepaired, in accordance with the agreement between X and Z, X shall pay several hundred millions of yen to Z as a penalty and Z may apply for arbitration in China for X's failure to perform its payment obligation. It was quite important for X to receive the device drawings from the bankruptcy trustee immediately, grasp the device mechanism, and repair the device.

Our firm represented X and required the bankruptcy trustee to provide the device drawings. However, the bankruptcy trustee insisted that there are no legal obligations to provide the device drawings and refused our request.

X must receive the device drawings from the bankruptcy trustee at any cost. However, according to the Japanese law and precedents, Y shall not be obliged to provide the device drawings because of Y's bankruptcy. Should X not have prepared for Y's bankruptcy, X may not be able to require Y to provide the device drawings. In such cases, X has no choice but to negotiate patiently with the bankruptcy trustee for its voluntary disclosure of the device drawings. We continued negotiation with the bankruptcy trustee and ultimately received the copy of the device drawings.

Practical tips

What should X do in the preparation for a similar situation in the future?

It is most desirable that X receives the copy of the device drawings from Y when X purchases the device so that X can maintain the device. However, if the device drawings include not only information specified to the device for X but also information which is common to many devices manufactured by Y, these drawings are valuable resources for Y, and thus Y will refuse to provide such drawings. Therefore, it is important for X to stipulate Y's duty in the agreement not only to maintain the device but also to provide the device drawings in the failure of the maintenance obligations. With such stip-

ulation, X will dominate the negotiation with the bankruptcy trustee because X is able to allege clear legal ground to demand the disclosure of the device drawings and the bankruptcy trustee shall accept X's demand unless the legal ground of rejection is found in the bankruptcy law, etc.

In this case, the situation became severe for X because a penalty provision disadvantageous to X was stipulated in the agreement between X and Z. From the business risk management viewpoint, X should be extremely cautious in accepting a penalty provision regarding matters being uncontrollable to X such as securing Y's maintenance of the device.

In technology transactions, companies should prepare for a trading partner's bankruptcy which is likely to cause a significant loss.