



ICLG

The International Comparative Legal Guide to:

Project Finance 2015

4th Edition

A practical cross-border insight into project finance

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Japan

Nagashima Ohno & Tsunematsu

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1 Overview

1.1 What are the main trends/significant developments in the project finance market in Japan?

After the introduction of a feed-in tariff (FIT) for renewable energy in July 2012, numerous “mega-solar” projects have mushroomed in Japan. In September 2014, however, Kyushu Electric Power suddenly suspended execution of new power purchase contract due to overcapacity of solar energy. The reform of FIT is under discussion and there will be little room for new mega-solar projects.

After the Great East Japan Earthquake in March 2011 and subsequent radiation leakage from Fukushima nuclear power plant, full reform of the power business is ongoing. Within a few years, power generation and the retail market will be fully liberalised and the transmission/distribution sectors will be separated from the power generation/retail sectors.

The PFI Law was amended in 2011 to introduce “concession rights” by which private sectors will take an initiative in the renovation or vitalisation of many ageing public facilities and infrastructure such as highways, sewage systems or public lands/buildings without relying on public sector credit or tax revenue. The Sendai Airport project and the Kansai and Osaka International Airports project are currently under a bidding process and their operations under private sector “concession rights” will commence from 2016.

In September 2014, the setting up and listing of “infrastructure funds” was liberalised. Currently, however, such fund shall invest in renewable energy generation facilities and lease them to the operators to gain tax benefit. Further relaxation of requirements for tax benefit is expected.

The 2020 Tokyo Olympic Games will necessitate significant construction and transportation infrastructure projects and their financing. The government also aims to have opened an “Integrated Resort (IR)” including casino facilities by then. If the bill liberalising casinos/IR is approved in the Diet, an enormous amount of project finance will be needed for development and construction of casino and other IR facilities.

1.2 What are the most significant project financings that have taken place in Japan in recent years?

The financing of Tokyo International Airport’s (Haneda) passenger terminal extension (2012) is one of the most significant project

financings in recent years. Syndicated loans of about JPY125 billion were made to Tokyo International Air Terminal Corporation, the project operator, by 20 financial institutions. As mentioned above, the Sendai Airport project and the Kansai and Osaka International Airports project will be landmark project financing transactions by use of concession rights in Japan, if closed.

2 Security

2.1 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In general, each asset shall be specified to create a valid security interest thereon. Assuming that each asset is sufficiently specified, a general security agreement on different types of asset security will be possible.

2.2 Can security be taken over real property (land), plant, machinery and equipment (e.g. pipeline, whether underground or overground)? Briefly, what is the procedure?

A (revolving) mortgage ((*ne*)*teito-ken*) may be created over land and building by the execution of a mortgage agreement and will be perfected by registration at the relevant registry. There are special types of mortgages – the “factory mortgage (*kojo-teito-ken*)” (for relatively small-sized factories) and the “factory foundation mortgage (*kojo zaidan teito-ken*)” (for large corporations’ factories) – which will cover factories’ real property, machinery and certain other assets.

Pledges (*shichi-ken*) can be created over land and building, equipment and machinery by execution of pledge agreements. In case of a pledge upon movables, their possessions shall be transferred to the pledgees, which may not be substituted by registrations with the Nakano registry.

Security Assignments (*joto tanpo-ken*) may be also created over land and building, machinery and equipment by execution of security assignment agreements. Unlike pledges, the assignor can continue to hold the possession of the collateral movables for and on behalf of the assignee (*senyu-kaitei*).

2.3 Can security be taken over receivables where the chargor is free to collect the receivables in the absence of a default and the debtors are not notified of the security? Briefly, what is the procedure?

Pledge or security assignment can be taken over receivables without the debtors' notification and insofar as no event of default occurs, the charger/assignor may be free to collect the receivables. To perfect such security interests against third parties, however, notice to the debtor or the debtor's acknowledgment will be necessary and such notice or acknowledgment shall be in writing and notarised (*kakutei hizuke*). Alternatively, registration filing with the Nakano Registry may be made without the debtor's notice.

2.4 Can security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security can be taken over bank time deposits by agreements and it will be perfected by notice to, or acknowledgment from, the bank. Meanwhile, the validity of security assignment over an ordinary account or current account is not clear since the outstanding amount of such accounts are always fluctuating and may not be specified.

2.5 Can security be taken over shares in companies incorporated in Japan? Are the shares in certificated form? Briefly, what is the procedure?

A security assignment or pledge can be taken over shares of *kabushiki kaisha* or "KK". If share certificates are issued, a pledge may be created by mutual agreements and perfected by delivering possession of such share certificates to the pledgee. If no certificates are issued, a pledge is created by mutual agreements and perfected by registration in the shareholders' register. A pledge over listed shares is created and perfected when the Japanese Securities Depository Centre, Inc. (and the financial institution with which the account is maintained under the book-entry system) debits the pledgor's account and credits the pledgee's account. The issuer company's approval will not initially be required but will be needed when it is to be enforced. For security assignments, the issuer company's approval will be necessary at the time of its creation as well as its enforcement. The validity or the perfection method of a pledge over ownership interests of *Godo Kaisha* or "GK" is not clear.

2.6 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets (in particular, shares, real estate, receivables and chattels)?

For mortgages on land and buildings, registration tax is 0.4% of the secured claim; "factory foundation mortgage" tax is 0.25% of the secured claim; for movable assignment registration, the registration fee is JPY7,500 per filing (up to 1,000 movables); for claim assignment registration, the fee is JPY7,500 per filing (up to 5,000 receivables, JPY15,000 above); and for pledges over intellectual property, the fee is 0.4% of the secured claim. The date-certification notary fee is JPY700 per notary. Stamp duty is JPY200 per receivables security assignment agreement.

2.7 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, except for "factory foundation mortgages" (see question 2.2).

2.8 Are any regulatory or similar consents required with respect to the creation of security over real property (land), plant, machinery and equipment (e.g. pipeline, whether underground or overground), etc.?

In general, no.

3 Security Trustee

3.1 Regardless of whether Japan recognises the concept of a "trust", will it recognise the role of a security trustee or agent and allow the security trustee or agent (rather than each lender acting separately) to enforce the security and to apply the proceeds from the security to the claims of all the lenders?

The "security trustee" is recognised and may pursue such functions under the Trust Law of Japan (2007).

3.2 If a security trust is not recognised in Japan, is an alternative mechanism available (such as a parallel debt or joint and several creditor status) to achieve the effect referred to above which would allow one party (either the security trustee or the facility agent) to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Japan.

4 Enforcement of Security

4.1 Are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or the availability of court blocking procedures to other creditors/the company (or its trustee in bankruptcy/ liquidator), or (b) (in respect of regulated assets) regulatory consents?

Security shall be generally enforced through a court-supervised auction (*keibai*) but the relevant parties often agree to enforce it by a private sale. In case of regulated assets, the relevant authorities' consent might be required under the applicable regulatory laws.

4.2 Do restrictions apply to foreign investors or creditors in the event of foreclosure on the project and related companies?

In general, the same rules will be applied to foreign investors and creditors as to domestic ones.

5 Bankruptcy and Restructuring Proceedings

5.1 How does a bankruptcy proceeding in respect of the project company affect the ability of a project lender to enforce its rights as a secured party over the security?

Under the proceedings of bankruptcy (*hasan*) or civil rehabilitation (*minji saisei*), secured creditors can enforce security interests outside the proceedings (*betsujo-ken*). However, in case of a corporate reorganisation proceeding (*kaisha kosei*) which shall apply only to *kabushiki kaisha* (or “KK”) incorporated under the Company Law of Japan and certain other transitional companies (*tokurei yugen kaisha*), even enforcement of security interests might be suspended in the proceeding (*kosei-tampo-ken*).

5.2 Are there any preference periods, clawback rights or other preferential creditors’ rights (e.g. tax debts, employees’ claims) with respect to the security?

If a debtor repays its debts or grants security to a specific creditor after becoming “unable to pay its debts” and being aware of such situation or after a bankruptcy filing (or grants security without obligation or repays debts before maturity within 30 days prior thereto), then such act may be avoided by the bankruptcy trustees (*hinin-ken*). While administrative expenses, pre-bankruptcy adjudication taxes and priority claims (labour costs, etc.) have priority over unsecured creditors’ claims, secured creditors have priority over the collateral, unless avoided as above.

5.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

In general, there is no such exemption.

5.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of the project company in an enforcement?

Though self-help is unlawful, creditors may request the court to attach the debtor’s assets or to issue a provisional court order requesting the debtor to take or not to take certain actions beneficial/harmful to creditors.

5.5 Are there any processes other than formal insolvency proceedings that are available to a project company to achieve a restructuring of its debts and/or cramdown of dissenting creditors?

“Turnaround ADR proceeding” (presided by the Japanese Association of Turnaround Professionals) is an independent out-of-court debt restructuring procedure to be pursued among financially distressed companies and their financial creditors. Under such proceeding, however, a debt rescheduling or reduction plan shall be valid only if it is consented to by all the relevant creditors.

5.6 Please briefly describe the liabilities of directors (if any) for continuing to trade whilst a company is in financial difficulties in Japan.

Liability can arise under the provisions of the Companies Act for

directors’ conduct which is harmful to the company, the creditors or other third parties, in which case civil damages or criminal sanctions may be imposed on such directors.

6 Foreign Investment and Ownership Restrictions

6.1 Are there any restrictions, controls, fees and/or taxes on foreign ownership of a project company?

Advance filings may be required for share acquisitions in certain regulated industries pursuant to the Foreign Exchange and Foreign Trade Law (FEFTL) (e.g. the oil, gas, electricity, nuclear, telecommunications, transportation and water supply sectors and other businesses having national security implications, etc.) and/or other industry-specific laws (e.g. broadcasting, aviation, radio waves, etc.).

6.2 Are there any bilateral investment treaties (or other international treaties) that would provide protection from such restrictions?

No, there are no such treaties.

6.3 What laws exist regarding the nationalisation or expropriation of project companies and assets? Are any forms of investment specially protected?

Under the Compulsory Purchase of Land Act, expropriation of land for public use (e.g. for airports, healthcare, waste disposal, pipelines, power facilities, etc.) may be possible with certain compensation.

7 Government Approvals/Restrictions

7.1 What are the relevant government agencies or departments with authority over projects in the typical project sectors?

While it will depend on the scope, nature or size of the project, usually the Ministry of Land, Infrastructure, Transportation and Tourism (MLIT) or the Ministry of Economy Trade and Industry (METI) will be the relevant authorities.

7.2 Must any of the financing or project documents be registered or filed with any government authority or otherwise comply with legal formalities to be valid or enforceable?

Execution of security documents, guarantees or loan agreements and foreclosure of security may trigger reporting requirements under the FEFTL. Other additional registration or filing requirements might be required depending on the nature of the project under the FEFTL or other industry-specific laws. Under the Civil Code of Japan, guarantees must be made in writing. Stamp duties might be imposed upon loan, guarantee and other project documents.

7.3 Does ownership of land, natural resources or a pipeline, or undertaking the business of ownership or operation of such assets, require a licence (and if so, can such a licence be held by a foreign entity)?

Land ownership does not generally require any licence but it might

be required under numerous special laws such as the Agricultural Land Law, the National Land Use Planning Law, the City Planning Law, the Road Law, the Building Standards Law, the Basic Law for Environmental Pollution Control, the Factory Location Law and the Cultural Assets Protection Law. Likewise, licences or permits will be required for projects involving oil and gas pipelines under the Mining Law, the Mining Safety Law, the Petroleum and Combustible Natural Gas Resources Development Act, the Petroleum Pipeline Business Law, the Gas Utilities Industry Law and the High Pressure Gas Safety Law. Mining rights will be granted only to Japanese persons (including those under foreign control).

7.4 Are there any royalties, restrictions, fees and/or taxes payable on the extraction or export of natural resources?

Mining operators/right-holders pay mineral production tax (1% of turnover) and mining allotment area tax. There are no export restrictions.

7.5 Are there any restrictions, controls, fees and/or taxes on foreign currency exchange?

No, except for *post-facto* reporting requirements under the FEFTL. Foreign exchange gains will be taxable profits.

7.6 Are there any restrictions, controls, fees and/or taxes on the remittance and repatriation of investment returns or loan payments to parties in other jurisdictions?

Dividends and interest paid abroad by Japanese entities are subject to withholding tax at 20% (20.42% including special reconstruction income tax), subject to Double Tax Treaties. Capital can be freely repatriated, any excess being taxable dividends. Capital gains by transfers of shares may be taxed in Japan.

7.7 Can project companies establish and maintain onshore foreign currency accounts and/or offshore accounts in other jurisdictions?

Yes, they can.

7.8 Is there any restriction (under corporate law, exchange control, other law or binding governmental practice or binding contract) on the payment of dividends from a project company to its parent company where the parent is incorporated in Japan or abroad?

No restriction is applicable (provided the dividend is not illegal).

7.9 Are there any material environmental, health and safety laws or regulations that would impact upon a project financing and which governmental authorities administer those laws or regulations?

There are several laws dealing with health and safety and the environment. Health-related laws are enforced by the Ministry of Health, Labour and Welfare; and environmental laws (including the Soil Contamination Countermeasures Law) are enforced by the Ministry of the Environment.

7.10 Is there any specific legal/statutory framework for procurement by project companies?

No, there is no such regulation.

8 Foreign Insurance

8.1 Are there any restrictions, controls, fees and/or taxes on insurance policies over project assets provided or guaranteed by foreign insurance companies?

Save for limited exceptions, foreign insurers doing business in Japan (e.g. insuring property located in Japan) should be established and licensed in Japan.

8.2 Are insurance policies over project assets payable to foreign (secured) creditors?

Yes, they are.

9 Foreign Employee Restrictions

9.1 Are there any restrictions on foreign workers, technicians, engineers or executives being employed by a project company?

No, provided entry (visa) and registration procedures are duly complied with (obtaining working visas for unskilled workers may be difficult in Japan).

10 Equipment Import Restrictions

10.1 Are there any restrictions, controls, fees and/or taxes on importing project equipment or equipment used by construction contractors?

While there exist certain limited restrictions under the FEFTL, project equipment is rarely subject to such restrictions.

10.2 If so, what import duties are payable and are exceptions available?

Import duties are applicable depending on product classification, origin and condition. However, machinery and mechanical appliances and electrical equipment will generally be exempted from import duties.

11 Force Majeure

11.1 Are force majeure exclusions available and enforceable?

Yes, they are commonly found, even in domestic project finance documents.

12 Corrupt Practices

12.1 Are there any rules prohibiting corrupt business practices and bribery (particularly any rules targeting the projects sector)? What are the applicable civil or criminal penalties?

Corrupt business practices and bribery will be subject to penalties under the Criminal Code and the Unfair Competition Prevention Law of Japan. Such penalties include imprisonment and fines for bribing domestic and foreign public officials (a JPY300 million fine for companies in the latter case), and collaterally being excluded from public tenders.

13 Applicable Law

13.1 What law typically governs project agreements?

Domestic project agreements are typically governed by Japanese law.

13.2 What law typically governs financing agreements?

Domestic financing agreements are typically governed by Japanese law.

13.3 What matters are typically governed by domestic law?

Most matters relevant to domestic projects are governed by Japanese law.

14 Jurisdiction and Waiver of Immunity

14.1 Is a party's submission to a foreign jurisdiction and waiver of immunity legally binding and enforceable?

Generally, yes.

15 International Arbitration

15.1 Are contractual provisions requiring submission of disputes to international arbitration and arbitral awards recognised by local courts?

Generally, yes.

15.2 Is Japan a contracting state to the New York Convention or other prominent dispute resolution conventions?

Yes. Japan is also a party to multilateral conventions including the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).

15.3 Are any types of disputes not arbitrable under local law?

Only civil disputes comprising among the relevant parties (excluding disputes over divorce and dissolution) are arbitrable unless otherwise

provided under law (e.g. an arbitration clause upon future labour disputes is invalid).

15.4 Are any types of disputes subject to mandatory domestic arbitration proceedings?

No, there is no such type of dispute.

16 Change of Law / Political Risk

16.1 Has there been any call for political risk protections such as direct agreements with central government or political risk guarantees?

No, to the best of our knowledge.

17 Tax

17.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

See question 7.6. While the treatment of the proceeds of a claim under guarantee is unclear, it would depend on the terms of the guarantee agreement. The proceeds of enforcing security would attract withholding income tax if they are deemed Japanese-source income.

17.2 What tax incentives or other incentives are provided preferentially to foreign investors or creditors? What taxes apply to foreign investments, loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Tax incentives are available under the recent Asian Business Location Law (preferential corporate and income taxes) and the National Strategic Special Zone Law (deregulation, subsidies and preferential taxes).

18 Other Matters

18.1 Are there any other material considerations which should be taken into account by either equity investors or lenders when participating in project financings in Japan?

If granting loans constitutes "money lending business" in Japan, a money lending licence will be required under the Money Lending Business Law.

18.2 Are there any legal impositions to project companies issuing bonds or similar capital market instruments? Please briefly describe the local legal and regulatory requirements for the issuance of capital market instruments.

Under the Financial Instruments and Exchange Law, a securities offering to the public shall be subject to strict obligations of disclosure and filing of securities registration statements unless "private placement", "small amount offering" or certain other exemptions are applicable.

19 Islamic Finance

19.1 Explain how *Istina'a*, *Ijarah*, *Wakala* and *Murabaha* instruments might be used in the structuring of an Islamic project financing in Japan.

Since 2009, subject to certain limitations, subsidiaries of Japanese banks and insurers may engage in Islamic finance transactions including *Murabaha* and *Ijarah*. In 2011, the Asset Securitisation Law was amended (with tax treatment of profit distributions to foreign investors) to facilitate *Shari'ah*-compliant financing structures using *sukuk* and *sukuk-al-ijarah*.

19.2 In what circumstances may *Shari'ah* law become the governing law of a contract or a dispute? Have there been any recent notable cases on jurisdictional issues, the applicability of *Shari'ah* or the conflict of *Shari'ah* and local law relevant to the finance sector?

No, there have not been any recent notable cases of this nature.

19.3 Could the inclusion of an interest payment obligation in a loan agreement affect its validity and/or enforceability in Japan? If so, what steps could be taken to mitigate this risk?

No, it would not, unless Islamic law applies.



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* Please note that the Tokyo office is scheduled to relocate in early May, so the above address and contact details are correct as from May 2015.

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