



ICLG

The International Comparative Legal Guide to:

Project Finance 2016

5th Edition

A practical cross-border insight into project finance

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Japan

Nagashima Ohno & Tsunematsu

Masayuki Fukuda



1 Overview

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

After the introduction of a feed-in tariff (FIT) for renewable energy in July 2012, photovoltaic (PV) power projects have been oversupplied, and following Kyushu Electric Power's suspension of execution of a new power purchase contract in September 2014, Kyushu and certain other utility companies are permitted to impose uncompensated and unlimited restraint on power supply by newly executing PV power suppliers.

Meanwhile, 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 operation of Sendai Airport and Kansai and Osaka International Airports by private entities with concession rights will be commenced in around mid-2016.

In September 2014, the setting up and listing of "infrastructure funds" as an investment corporation becomes possible by the relevant amendment to the Law on Investment Trust and Investment Corporation. Further relaxation of requirements for anti-double taxation is expected to allow the infrastructure fund business to flourish in Japan.

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

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. Similarly, the operation of Takamatsu Airport will be entrusted to a private entity with concession rights from 2018. The Setouchi Mega Solar Project (230 megawatts in power, with a loan in the amount of JPY90 billion, and whose operation will commence in 2019) is one of the largest mega-PV power projects.

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 buildings by the execution of a mortgage agreement, and will be perfected by registration at the relevant registry. There are special types of mortgage – the "factory mortgage" (*kojo-teito-ken*) (for relatively small factories) and the "factory foundation mortgage" (*kojo zaidan teito-ken*) (for large corporations' factories) – which will cover factories' real property, machinery and certain other pertinent assets. In addition, railroads, mining rights, canals, port transport businesses, road traffic businesses, sightseeing facilities and certain other assets may constitute a foundation to be mortgaged under special foundation mortgage laws.

Pledges (*shichi-ken*) can be created over land, buildings, 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 also be created over land, buildings, 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?

A pledge or security assignment can be taken over receivables without the debtors being notified 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 a security assignment over an ordinary account or current account is not yet clearly confirmed by Japanese courts.

2.5 Can security be taken over shares in companies incorporated in your jurisdiction? 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 agreement 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 be required initially, but will be needed when the pledge 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 of a pledge over ownership interests of *godo kaisha* or "GK" has not yet been clearly confirmed by Japanese courts.

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 your jurisdiction 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 your jurisdiction, 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?

See question 3.1 above.

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 KJs 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-tanpo-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?

Since self-help is unlawful, there are no such processes, other than court proceedings.

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?

A "turnaround ADR proceeding" (presided over 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 informal 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 your jurisdiction.

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 natural or judicial 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 your jurisdiction 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 and import duties (see question 10.2 below), 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?

While such exclusions are commonly provided for in project finance documents, the validity and the scope thereof has not been clearly confirmed by a Japanese court.

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 your jurisdiction 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 between 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 there has been no such call.

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 your jurisdiction?**

If granting loans constitutes "money lending business" in Japan, a money lender's registration 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 your jurisdiction.

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 your jurisdiction? If so, what steps could be taken to mitigate this risk?

No, it would not, unless Islamic law applies.



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