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Contents

Nagashima Ohno & Tsunematsu is one of the foremost providers of international and commercial legal services based in Tokyo. The firm has over 450 lawyers, including over 30 experienced foreign attorneys from various jurisdictions, and its overseas network includes offices in New York, Singapore, Bangkok, Ho Chi Minh City, Hanoi and Shanghai, and collaborative relationships with prominent local law firms throughout Asia and other regions. The firm regularly advises leading power utilities, trading companies and investors on their energy projects as well as regulatory matters, and financial institutions on financing on those projects. The firm has dealt with a number of renewable power projects since the introduction of the feed-in tariff in Japan. In recent years, the firm has represented financial institutions on project finance in relation to concessions of public infrastructure, including the concession of Fukuoka International Airport and the concession of two Kansai international airports.

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1. Project Finance Panorama

1.1 Recent Trends and Development

As the growth of solar projects slows down, offshore wind farms have attracted attention from the market. A new legislation to support the development of offshore wind farms passed the Diet on 30 November 2018 and came into force on 1 April 2019. One of the major issues around offshore wind farms was that there was no legal framework of granting a right to use the general sea area for a period sufficiently long enough to support a wind farm project (general sea area is sea area that does not fall within the definition of port and harbour area, for which area the Port and Harbour Act introduced such legal framework in 2018). Under the new legislation, the national government designates certain sea area for the development of wind farm projects and solicits a proposal from private developers. A winning developer will be awarded a right to use that sea area (down to 100 metres below the sea level and up to 315 metres above) for up to 30 years. The national government is in the course of selecting the sea area, and has announced that 11 sea areas are being considered, and out of those, four sea areas will be designated ahead of the other sea areas. Those four areas are: Noshiro/Mitane/Oga sea area in Akita, Yurihonjo sea area in Akita, Choshi sea area in Chiba and Goto sea area in Nagasaki.

In the field of concession, Tottori Prefecture launched the bidding of concession of four over 50-year-old hydro power plants and facilities on 27 March 2019. The preferred bidder will be selected in February 2020. The concessionaire will upgrade the plants and facilities and operate them for 20 years (or 50 years if the option is exercised by the concessionaire). The concessionaire sells the power to the utility under the feed-in tariff (FiT) regime; ie, the fixed price for 20 years. Accordingly, although the concessionaire assumes the revenue risk vis-à-vis Tottori Prefecture, the project is effectively remote from the revenue risk. Once this project is successfully closed, it is expected that other aged hydro power plants operated by local governments will be tendered for concession.

The new field attracting the attention of the market is integrated resorts, which are a combination of facilities where a casino is a central and key component facility and surrounded by other facilities such as hotels, amusement facilities and convention centres. The Japanese government has targeted the opening of two integrated resorts as a first batch. Under the enactment of the Act on Development of Specified Complex Tourist Facilities Areas (Act No 80 of 2018), cities interested in developing an integrated resort find private-sector partners (including casino operators) and submit a joint proposal to the national government, and the national government selects two winning proposals. Several cities have

started a process of selecting private-sector partners; ie, issue of request for concept proposal. Financial institutions are exploring a solution of providing finance for construction cost by way of project-based finance.

In addition to the above, the amendment to the Civil Code that passed the Diet in 2017 will come into effect on 1 April 2020. As far as commercial transactions are concerned, most of the amendment is to clarify the prevailing interpretation of the current Civil Code and to codify the established court precedents, and so there would be no substantial change in the substance. However, as certain legal terms (eg, defect) are expressed in a different terminology in the amended Civil Code, documentations of project finance will reflect such terminology, and most financial institutions are reviewing their standard forms to be consistent with the amended Civil Code.

1.2 Sponsors and Lenders

Major players are slightly different depending on the types of projects. Conventional PFI projects – ie, availability-based accommodation projects – are occupied by domestic players, and international players are rarely seen. General construction companies and real estate developers are active as sponsors, and Japanese regional banks are active as lenders. That trend is also the case with concession projects, except that Japanese trading companies are more active, and, in the case of airport concessions, international airport operators are also active, while Japanese major banks take a lead in the organisation of a syndicate consisting of Japanese banks, and non-Japanese financial institutions sometimes participate in a project in which international sponsors are involved. A unique characteristic of PFI/PPP projects in Japan is that local companies of the project area are invited to hold a minority interest in a project company, as an expression of the sponsors' eagerness to contribute to the local economy. As such, it is not uncommon that a project company has more than ten shareholders.

In the case of power projects – in particular, renewable projects – Japanese trading companies and power utilities and other domestic and international developers are active as sponsors. Japanese banks are dominant as lenders.

Project finance in Japan is dominated by Japanese banks and there is very limited space for non-Japanese financial institutions. Also, project bonds are not common in the market.

1.3 Public-Private Partnership Transactions

PFI was introduced in 1999 when the Act on Promotion of Private Finance Initiative (Act No 117 of 1999, as amended; "PFI Act") was enacted. The PFI Act is the legislation governing PFI projects. Since the introduction of the PFI regime, many availability-based accommodation projects (eg, schools, hospitals, school catering service facilities and libraries) have been implemented. PFI was welcomed by local governments as a tool to spread the cost of investing in infrastructure through 20-30 years, although it has sometimes been targeted by critics arguing that it does not produce value for money.

Against that background, there was a major amendment to the PFI Act in 2011, which introduced the concession scheme. Under that scheme, a concessionaire is allowed to collect from the general public a commission, toll, fee or other consideration for use of the infrastructure that it operates. So the concession scheme is considered a flexible tool to structure a project where the private sector assumes all or part of the revenue/demand risk. The concession scheme was intended to be used for privatising the operation of certain infrastructure whose legal title cannot be transferred to the private sector due to national security or other political reasons. The first infrastructure focused on was airports. Since Kansai International Airport and Osaka International Airport were privatised through a 44-year concession with the use of approximately JPY200 billion of project finance, many airports have been tendered for concession. Ten airports are operated by the private sector under the concession scheme.

The national government is considering privatising other infrastructure using the concession scheme, such as water facilities, stadia and hydro power plants.

The PFI Act provides for the procedural requirements that the public sector must follow to initiate a PFI project and the rights and obligations granted to a private sector company under the PFI regime. However, the PFI Act itself does not legalise the private sector operating and maintaining public infrastructure, which needs to be legalised by a separate legislation. Accordingly, the concession scheme will not be available unless appropriate legislation has been enacted for the relevant public infrastructure. To date, such legislation has not been passed in respect of toll roads generally.

In addition to the general PFI/PPP regime under the PFI Act, an individual public property law also provides for a PPP regime applicable for specific public property. The Port and Harbour Act (Act No 218 of 1950, as amended) is an example.

As a part of the initiative to promote the tourism industry of Japan, the national government has set a target to increase the number of tourists coming to Japan by cruise ship to five million in 2020, and published a plan to develop ports for international cruise ships. In order to facilitate such development, the government has passed an amendment to the Port and Harbour Act to facilitate the development of such ports. Under that amendment, cruise ship operators that invest in developing or upgrading a terminal facility with a function of customs, immigration and quarantine (CIQ) at certain ports designated by the government are given pri-

ority to use those ports over other operators. To date, the government has designated seven seaports pursuant to the amended Port and Harbour Act: Yokohama (Kanagawa Prefecture), Shimizu (Shizuoka Prefecture), Sasebo (Nagasaki Prefecture), Yatsushiro (Kumamoto Prefecture), Motobu (Okinawa Prefecture), Hirara (Okinawa Prefecture) and Kagoshima (Kagoshima Prefecture).

1.4 Structuring the Deal

There are some characteristics unique to the Japanese project finance market, and understanding those characteristics will help in procuring project finance in Japan. Most notably, the structuring of project finance in Japan is largely influenced by asset finance; in particular, real estate finance. That tendency is stronger in renewable projects, which have boomed since the feed-in tariff was introduced in Japan in 2012. The bankruptcy remoteness requirement for a project company and *tokumei kumiai* (TK) investment are both imported from real estate finance.

Bankruptcy remoteness of a project company is satisfied if (i) the project company is a *godo kaisha* (GK), (ii) the GK's only legal equity holder is an *ippan shadan hojin* (ISH), (iii) the ISH is independent of the project sponsor and (iv) all the relevant persons waive the right to file for an insolvency proceeding with respect to the GK. A GK is to a *kabushiki kaisha* (KK) what an LLC would be to a corporation in the USA. An important difference between a GK and a KK is that a corporate reorganisation proceeding (*kaisha kousei tetsuzuki*), which is a Chapter 11 type proceeding, is not available to a GK. An ISH is a form of legal entity for a non-profit organisation, and an ISH is considered as independent of a project sponsor if it is incorporated by an independent accounting firm and whose officers are all assumed by accountants to be independent of a project sponsor. Usually, an ISH is incorporated with nominal funding such as JPY100,000. Further, GKs, ISHs and their respective officers deliver to project finance lenders a "non-petition letter" undertaking not to file for any insolvency proceeding with respect to the project company. By doing so, project finance lenders try to make the project company as remote as possible from legal insolvency proceedings.

In this regard, TK investment plays an important role. As the legal equity of a GK project company is held by an ISH that is independent of project sponsors, certain arrangements for project sponsors to inject money into the project company and receive returns from the money so injected are required. TK investment is employed for that purpose, as a substitute for legal equity. TK investment is an investment made pursuant to a *tokumei kumiai* contract (TK contract), which is a bilateral contract whereby one party (TK Operator) receives funds from the other party (TK Investor) and, with those funds, conducts certain pre-agreed business with a TK Investor, and shares profit generated from such business with the TK Investor. The business will be conducted in the name of the TK Operator and the TK Investor's liability is limited to the obligation to make an investment of the pre-agreed amount, which means TK investment is a limited liability investment. The TK Operator may enter into a TK contract for the same business with multiple parties, in which case, taken as a whole, the structure will be economically very similar to a limited liability company where the TK Operator is the company and TK Investors are members of the company. Under a TK contract, profit and loss allocated to TK Investor(s) is directly recognised by TK Investor(s), instead of the TK Operator. As such, if a TK contract is structured such that all or substantially all profit is allocated to a TK Investor, then TK interest effectively functions as legal equity does.

Another characteristic is that the debt-to-equity ratio is often required to be maintained not only during the construction period but also during the operation period. In such case, project sponsors need to structure their financial model carefully so that such requirement may not affect the return on invested capital.

2. Guarantees and Security

2.1 Assets Available as Collateral to Lenders

Under Japanese law, the principle is that any property having economic value can be taken as security unless creating a security interest in such property is prohibited by statutes.

There are three forms of security interest that are created by contract under Japanese law: mortgage (*teitoken*), pledge (*shichiken*) and collateral assignment (*joto tampo*). A mortgage and a pledge are both security interests recognised by statutes, while collateral assignment is security interest recognised through case law.

A mortgage is available for real estate, automobiles, vessels and aircrafts, and some other assets. Those assets are common in that the government has established and administered a title registration system for each asset, and perfection of title is made through such title registration system. A mortgage is also perfected through that registration system. As a special type of mortgage, there exist a factory mortgage (*kojo teito*) for a factory and a factory foundation mortgage (*kojo zaidan teito*) for a factory foundation (*kojo zaidan*). Where a factory mortgage is created over the site of a factory, the security interest extends to equipment and facilities used for the factory on that site providing that such equipment and facilities are registered as components of that factory under the title registration system. Where a factory foundation mortgage is created over a factory foundation, the security interest extends to property that is listed as property of that factory foundation. A factory foundation is permitted to own certain intangible property such as leasehold of the site and intellectual property.

A pledge is available for any property. However, as far as project finance is concerned, a pledge is not used for real estate or other tangible property, and a pledge is only used for intangible property such as receivables, bank accounts, insurances and shares in a company or other form of equity interest, copyrights, patents, etc. The most relevant reason is that if a pledge is created over tangible property, the pledgor is deprived of the right to use such property. It means that the project company cannot use its tangible property if a pledge is created over such tangible property. The way to perfect a pledge varies among the types of property. A pledge created over a receivable is perfected upon (i) a written acknowledgement by a debtor of the receivable with a date-certifying stamp or (ii) a written notice to the debtor with a date-certifying mail. The same applies to a bank account and an insurance because a bank account is considered as a depositor's receivable against the bank and a claim of insurance proceeds against an insurance company is also considered as a receivable against the insurance company. A pledge created over a share in a certificated company is perfected upon delivery of the share certificate representing such share, while a pledge created over a share in an uncertificated company is perfected upon recordation of the pledge on the shareholder ledger of that company and a pledge created over a share in a listed company is perfected upon recordation of the pledge under the share transfer recordation system administered by the Japan Securities Depository Center, Incorporated (JASDEC). A pledge created over intellectual property is perfected upon registration of a pledge under the registration system administered by the Patent Office. As an additional means of perfecting a pledge created over receivables, registering the pledge under the receivable registration system administered by the Ministry of Justice is also available. It saves much cost and time to obtain written acknowledgement from each debtor of those receivables or send written notice to each debtor.

Collateral assignment is also available for any property, but in the field of project finance, it is usually used for tangible property other than real estate; ie, movable property, and sometimes for receivables. Collateral assignment is used to function as a complement to a pledge, as collateral assignment does not deprive the owner of the property of the right to use it. Collateral assignment of movable property is perfected upon the owner of that movable property acknowledging the assignment. The owner is permitted to continue to hold and use the movable property as it did before the collateral assignment. Collateral assignment of intangible property is perfected in the same manner as a pledge. Collateral assignment of movable property and receivables can also be perfected by way of registering it under the registration system administered by the Ministry of Justice.

In addition to the above forms of security interests, as a substitute for taking a contract as security, a call option is granted by a project company to project finance lenders with respect to the contractual position the project company holds under a contract. Just as with security interest, the option becomes exercisable upon occurrence of an event of default or acceleration of debt, and if the option is exercised, the project company has to transfer its contractual position under that contract to any person that is designated by the lenders (including themselves). Such arrangement is referred to as "grant of call option (*joto yoyaku*) with respect to contractual position (*keiyakujonochii*)". It is not a security in a legal sense, but it is used to secure project finance lenders' step-in right to project agreements.

2.2 Charges or Interest over All Present and Future Assets of a Company

Japanese law does not recognise a floating charge of other universal or similar security interest over all present and future assets of a company.

2.3 Registering Collateral Security Interests

Registration tax (*torokumenkyo zei*) is imposed on registration of creation of security interest. In the case of a mortgage of real estate, the rate is 0.4% of the registered face value of the secured obligations, and 0.25% in the case of a factory mortgage or factory foundation mortgage. In the case of a pledge or collateral assignment, registration tax is JPY7,500 per registration.

2.4 Granting a Valid Security Interest

With respect to property on which a mortgage is created, each property is individually identified in the security document as registration is made on each property.

With respect to movable property and receivables to which collateral assignment is created, each item of collateral does not need to be individually identified in the security document to grant a valid security interest in that item, and a general description of the types of collateral covered would be sufficient as long as such description can distinguish the assets subject to the security interest from the other assets of the security provider.

2.5 Restrictions on the Grant of Security or Guarantees

Under Japanese law, a third-party liability insurance cannot be taken as security.

Under the current Civil Code (which amendment will come into effect on 1 April 2020), receivables with an agreement to prohibit transfer attached cannot be taken as security unless a waiver of such prohibition is obtained from the debtor of such receivables. That will change under the amended Civil Code, where receivables with such agreement attached are taken as security without obtaining the debtor's waiver.

Under Japanese law, each of the three forms of security interest as well as guarantee can be created in two ways; ie,

ordinary security/guarantee (*futsu tampo/hosho*) and revolving security/guarantee (*ne tampo/hosho*). The former is to secure identified specific obligations (eg, term loans), while the other is to secure unidentified obligations that arise out of a certain specific type of transaction or a certain specific contract (eg, revolving loans, claims under hedging agreements). Once the obligations secured by revolving security/guarantee are fixed (ie, crystallised), then such revolving security/guarantee becomes an ordinary security/guarantee.

Revolving security/guarantees were invented and developed through practice and later ratified by case law. While a revolving mortgage (*ne teitoken*) was codified thereafter, a revolving pledge (*ne shichiken*) and revolving collateral assignment (*ne joto tampo*) have not been codified. Practitioners employ a revolving pledge and revolving collateral assignment, with the understanding that the provisions of a revolving mortgage should apply to a revolving pledge and revolving collateral assignment; however, such practice has not been tested by a court with respect to all of those provisions of a revolving mortgage.

Another issue is related to a revolving mortgage. As is the case with an ordinary mortgage (*futsu teitoken*), the value of obligations secured by a revolving mortgage must be registered. However, it may not be easy to estimate the maximum exposure a hedging provider may have during the project. At the same time, the rate of registration tax (*torokumenkyo zei*) depends on such amount. So the value of obligations secured as registered must be agreed between project finance lenders and project sponsors.

2.6 Absence of Other Liens

There are a number of types of statutory liens under Japanese law, and some are attached to an employee's salary claims, certain construction fees, receivables of sellers of goods, funeral costs, etc. Certain statutory liens have to be registered under the title registration system to secure their priority, and so lenders can confirm whether those statutory liens exist by way of confirming the title registration records. For the other statutory liens, lenders have no means to confirm whether those statutory liens exist.

2.7 Releasing Forms of Security

In principle, the security interest automatically ceases to have effect upon the secured obligations being discharged in full, but it is common practice for the lender to deliver a release letter confirming that the security interest no longer exists. Such release letter is more important if the security interest is revolving security interest/guarantee, because the revolving security interest/guarantee does not necessarily extinguish when the outstanding secured obligations are discharged in full.

Further, if the security interest is registered, removing registration is necessary, and if a pledge or collateral assignment is made by way of sending a written notice or obtaining a written acknowledgment from debtors, then reversion of the collaterals must be perfected in the same manner as the creation of security interest.

3. Enforcement

3.1 Enforcement of Collateral by Secured Lender

Under Japanese law, a secured lender can enforce its collateral when the debt secured by such collateral is not paid on the day when it becomes due and payable. Under a financing agreement, the parties agree to a set of events or circumstances that would make outstanding loans immediately due and payable. Those are called an event of default or event of acceleration (*kigennorieki soshitsujiyu*). Some of those events or circumstances automatically accelerate the loans, while others only accelerate the loans if the lender so notifies the borrower.

Under Japanese law, there are two means to enforce security interest: in-court foreclosure and out-of-court foreclosure. However, unlike mortgages and pledges, in-court foreclosure is not available to collateral assignment, and out-of-court foreclosure is the only means to enforce collateral assignment.

In order to enforce your right, in general, you have to obtain a judgment of a court (or arbitration award if arbitration is an agreed method of dispute resolution) beforehand and present it in front of an execution court. However, in the case of enforcing security, you only have to prove the existence of your security by way of presenting an executed security agreement and/or relevant perfection documents in front of an execution court. You do not have to obtain a judgment that the debt secured is due and payable, and has not been discharged yet. Once the existence of your security interest is proved, it is the debtor that owes the burden of proof on those facts. Where enforcement of security interest is filed with an execution court, the execution court will usually hold a public auction, the collateral will be sold to the highest-price bidder and the security interest holder will receive net proceeds from the sale of the collateral.

Security can be enforced outside of a court provided that the process of so enforcing security is agreed and set out in a security agreement. It is standard practice in a Japanese financing transaction to set out in a security agreement (i) the right of a secured party to dispose of subject property on behalf of a security provider and apply disposition proceeds to a secured claim, and (ii) the right to appropriate subject property at its appraised value.

It is generally considered that security can be more promptly enforced and greater value will be realised from enforcement

if it is enforced outside of a court than through an in-court foreclosure proceeding.

3.2 Foreign Law

The Act on General Rules for Application of Laws (Act No 78 of 2006, as amended) covers the issue of conflict of laws in Japan. It allows parties to a contract to choose the jurisdiction to govern that contract. Accordingly, courts of Japan generally uphold a choice of foreign law in a contract. However, under that Act, if a court finds that application of a foreign law chosen by agreement between the parties to a contract would lead to a consequence that is detrimental to the public order of Japan, the court will refuse to apply the chosen foreign law and apply Japanese law instead. Further, laws and regulations of certain area of law – eg, antitrust law, foreign exchange law, labour law, usury law and real estate lease law – are considered as mandatory rules, and, therefore, apply despite a choice of foreign law.

The Code of Civil Procedure (Act No 109, 1996, as amended) provides that parties may choose a court in a foreign country as an agreed venue of dispute resolution. Accordingly, courts of Japan generally recognise a choice of foreign jurisdiction made in a contract. However, that Code also provides that a choice of a foreign jurisdiction will not be upheld if it is held that a court in that country does not have the capability (legally or otherwise) of exercising its jurisdiction.

3.3 Judgments of Foreign Courts

As Japan is a member state of the New York Convention, an arbitral award would be recognised by courts of Japan, and may be enforced without retrial of the merit, in accordance with, and subject to, the New York Convention and the Arbitration Act (Act No 138 of 2003, as amended).

A final judgment rendered by a foreign court would be recognised, and may be enforced without retrial of the merit if such judgment satisfies a certain set of requirements set out in Article 118 of the Code of Civil Procedure. Among those requirements are that reciprocity between the country of the relevant judgment and Japan is assured, and that the terms of the judgment and the judicial procedure through which the judgement was rendered do not conflict with the public order and morality of Japan.

3.4 A Foreign Lender's Ability to Enforce

In a judicial proceeding in Japan, Japanese citizens and foreigners are treated equally, and there are no substantive restrictions on a foreign lender's ability to enforce its rights under a loan or security agreement. However, as the official language in Japanese courts is Japanese, a foreign lender would have to prepare a Japanese translation of the documents produced by its home country's government – eg, certificate of incorporation – to establish its identity.

Further, where a foreign lender that files a claim with a court does not have any presence in Japan, a Japanese court would likely order a security deposit from such lender to cover costs and expenses that may be incurred by the court in relation to a trial of such claim.

4. Foreign Investment

4.1 Restrictions on Foreign Lenders Granting Loans

Except where a foreign bank grants a loan through its licensed branches in Japan, a foreign lender must have the money lending licence under the Money Lending Business Act (Act No 32 of 1983, as amended) in order to engage in the business of granting loans or the money lending business.

Whether granting a loan is conducted as business for the purpose of that Act is a fact-oriented issue, and attention is required when a project sponsor injects equity by way of extending a subordinated loan as it is often considered that if a person is expected to extend a loan more than once, such person is deemed to engage in the money lending business for the purpose of that Act. If such project sponsor has 20% or more of the shares in the project company, then such project sponsor's extending loans to such project company would be exempted as intra-group financing. If a project sponsor's share is less than 20%, then such project sponsor effectively cannot use subordinated loans as a means of injecting equity. In such case, bonds (*shasai*) would be employed as a substitute for subordinated loans, as subscribing for a bond is not considered as money lending for the purpose of that Act.

4.2 Restrictions on the Granting of Security or Guarantees to Foreign Lenders

In general, there are no restrictions on granting of security or guarantees to foreign lenders, and foreign lenders may take security or guarantees in the same manner as Japanese lenders do.

4.3 Foreign Investment Regime

Foreigners' investment in Japan is liberalised and, in general, foreigners who (i) have acquired a share in an unlisted company or 10% of shares in a listed company, or (ii) have provided finance of JPY100 million or more by way of extending a loan or subscribing for a bond with a tenor of one year or more to a company that has resulted in 50% or more of such company's outstanding debt with a tenor of one year or more being owed to such investor only have to file ex post facto notification to the Bank of Japan under the Foreign Exchange and Foreign Trade Act (Act No 228 of 1949, as amended).

However, that Act restricts foreign investment in a certain industry due to certain political reasons such as national security, safety, industry protection and public interest, and a foreign investor may not make investments unless he makes an ex ante notification and the required waiting period elapses. In principle, the length of the waiting period is 30 days, but it may be shortened to two weeks or extended up to five months, at the discretion of the government. In the meantime, the waiting period is shortened to five business days if an investment falls within one of the following categories:

- to incorporate a wholly owned subsidiary in Japan or acquire equity in, or debt of, such subsidiary, or to open a branch in Japan ("greenfield investment");
- to acquire additional equity in a Japanese company without changing its shareholding therein and with no change in the management structure thereof, within six months from the most recent acquisition of equity therein for which the ex ante notification was made ("rollover investment"); and
- to acquire equity in, or debt of, a Japanese company as a passive investor having no voting right on material management matters ("passive investment").

However, if the contemplated investment does not fall within any of such categories, and, during the waiting period, the government has determined that the investment may undermine national security, public order, or public safety, or adversely affect the national economy, the government may issue a warning to change the terms of, or surrender, the investment, and if the investor does not respond to the warning or expresses his intention to disobey the warning, the government may issue an order to change the terms of, or surrender, the investment. The foreign lender's enforcing of its security of shares in a Japanese company of such regulated industry may be restricted by such regulations.

Further, companies in certain regulated industries are subject to a nationality requirement under the respective industry regulations, and that a prescribed majority of shareholding of those companies is owned by Japanese citizens and Japanese corporations is a requirement for maintaining the licence to conduct their business. A broadcasting company under the Broadcasting Act (Act No 132 of 1950, as amended) and an airline company under the Aviation Act (Act No 231 of 1952, as amended) are those examples. If a foreign lender take shares in such company as security, the foreign lender may only enforce the security by way of selling such shares to Japanese citizens or Japanese corporations.

4.4 Restrictions on Payments Abroad or Repatriation of Capital

Under the Foreign Exchange and Foreign Trade Act, ex post facto notification to the Bank of Japan is usually required for cross-border payment of more than JPY30 million unless such payment is made in connection with an international trade of goods.

Under Japanese tax law, payment of dividends, interest on loans or profit generated from TK investment are all subject to withholding tax of 20.42%, unless the country of a receiving person has entered into a tax treaty with Japan, in which case the withholding tax may be exempted or reduced in accordance with such tax treaty.

4.5 Offshore Foreign Currency Accounts

A project company is permitted to maintain offshore foreign currency accounts.

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing of Project Agreements

None of the financing or project agreements need to be registered or filed with any government authority or otherwise need to comply with local formality to be valid or enforceable, except that certain security interest would have to be registered in order to be perfected (such registration would contain a basic term of the obligations secured by the security; eg, amount and interest rate).

5.2 Licence Requirements

Unless engaging in real estate brokerage business, no licence is required for owning land of Japan, in general.

Minerals or other natural resources, such as natural gas and crude oil, may not be extracted without a licence under the Mining Act (Act No 289 of 1950, as amended), and such licences are not granted to non-Japanese persons or corporations.

5.3 Agent and Trust Concepts

Agency and trust are both recognised in Japan. In particular, the new Trust Act (Act No 108 of 2006) clarifies that creating a security trust is permissible. However, due to some practical reasons, security trust is not commonly used in project finance or any other syndicated lending transactions in Japan. As such, security is granted to each of the lenders individually, and every time that a lender disposes of its shares in a syndicated facility, a new lender has to perfect the acquisition of certain security interests and guarantees because an ordinary security interest/guarantee is tagged with and carries with the loans secured by such ordinary security interest/guarantee by operation of law, while revolving security interest\guarantee does not transfer along with the obligations secured by that revolving security interest/guarantee until it is crystallised.

5.4 Competing Security Interests

Where security interests compete each other, the priority will be determined by way of the time on which the security interest is perfected. The security interest that is perfected earlier will have priority over that which is perfected later.

In order to agree on the priority on enforcement proceeds otherwise, secured lenders enter into an intercreditor agreement. An execution court would not uphold such intercreditor agreement and it would distribute enforcement proceeds to secured lenders in accordance with the priority determined by way of the time on which the security interest is perfected and in accordance with the relevant statutes that determines the priority among the security interest and other statutory liens. After distribution of such proceeds is made by an execution court, the secured creditors who received such proceeds are obliged to redistribute such proceeds so that the secured creditors will receive enforcement proceeds as contemplated by the intercreditor agreement.

Further, where a sponsor injects equity by way of subordinated debt or TK investment instead of legal equity (ie, subscribing for shares), project finance lenders usually procure a subordination undertaking from such sponsor, which would be upheld by a bankruptcy court or a bankruptcy trustee.

5.5 Local Law Requirements

Japanese law does not require a project company to be incorporated under the laws of Japan. However, in the case of PFI/PPP projects, the procuring authority always requires in its request for proposal that a project company be a corporation incorporated under the laws of Japan, usually a *kabushiki kaisha*.

As a matter of practice, it is extremely rare that a project company is a foreign-law corporation, and a typical form of a project company is *kabushiki kaisha* or *godo kaisha*.

6. Bankruptcy and Insolvency

6.1 Company Reorganisation Procedures

Under Japanese law, there are four types of insolvency proceedings: bankruptcy proceeding (*hasan tetsuduki*), special liquidation proceeding (*tokubetsu seisan tetsuduki*), civil rehabilitation proceeding (*minji saisei tetsuduki*) and corporate reorganisation proceeding (*kaisha kosei tetsuduki*).

Out of those four types of insolvency proceedings, a civil rehabilitation proceeding and a corporate reorganisation proceeding are reorganisation-type procedures, and a bankruptcy proceeding and a special liquidation proceeding are liquidation-type proceedings. A special liquidation proceeding and a corporate reorganisation proceeding are only available to a *kabushiki kaisha*.

A civil rehabilitation proceeding is often referred to as a debtor-in-possession (DIP) proceeding, as the management of a debtor continues to operate the debtor's business while being overseen by a supervisor (*kantoku iin*) appointed by a court.

A corporate reorganisation proceeding is another reorganisation procedure, where a reorganisation trustee (*kosei kanzainin*) appointed by a court would operate and protect the debtor's business and property.

6.2 Impact of Insolvency Process

Where an insolvency proceeding commences with respect to a debtor, creditors of that debtor may not enforce their rights outside those proceedings. In a liquidation-type proceeding, they will only receive distributions from the proceeds of disposition of the debtor's assets. In a reorganisation-type proceeding, creditors of a debtor have rights to vote on a proposed rehabilitation/reorganisation plan, and their claims will be paid off in accordance with the approved rehabilitation/reorganisation plan.

In the meantime, the commencement of an insolvency proceeding other than a corporate reorganisation proceeding shall not prevent secured creditors from enforcing their security outside the insolvency proceeding, and recovering their loans from enforcement proceeds of the collateral. To the contrary, under the corporate reorganisation proceeding, secured creditors are not allowed to enforce their security. It is the reason that project finance lenders preferring bankruptcy remoteness require that a project company be a *godo kaisha*.

6.3 Priority of Creditors

In the case of insolvency proceedings other than corporate reorganisation proceedings, while secured creditors may recover their outstanding loans from enforcement proceeds of the collaterals, secured creditors may also recover their outstanding loans from the debtor's general assets to the extent that those secured creditors cannot fully recover their loans from enforcement proceeds of the collaterals. Proceeds from disposition of the debtor's general assets shall be distributed to creditors on a pro rata basis. In the case of a corporate reorganisation proceeding, all the creditors, including secured creditors, will recover their outstanding loans in accordance with the approved reorganisation plan.

In the meantime, debt with a certain subordination agreement shall be treated as such under the respective insolvency proceedings. Where a sponsor injects equity by way of subordinated debt or TK investment instead of legal equity, project finance lenders usually procure that any claims in relation to such instrument have a clause of such subordination agreement.

6.4 Risk Areas for Lenders

A debtor that has become insolvent is unlikely to have assets to discharge all its outstanding debts, so creditors that do not have sufficient security would end up writing off their loans. Those creditors may try to take some of the debtor' assets as security to secure their priority on those assets. However, such action may be avoided as preference if an insolvency proceeding commences with respect to that debtor.

Where a corporate reorganisation proceeding commences, the secured creditors are not allowed to enforce their collaterals until the approved reorganisation plan is fully implemented and may be forced to write off their loans if such reorganisation plan is approved.

6.5 Entities Excluded from Bankruptcy Proceedings

There are no entities that are excluded from insolvency proceedings in Japan.

7. Insurance

7.1 Restrictions, Controls, Fees and/or Taxes on Insurance Policies

As far as insurance policies used in relation to project finance are concerned, there would be no restrictions or controls on insurance policies provided by insurance companies.

7.2 Foreign Creditors

There are no restrictions on foreign creditors receiving proceeds from insurance policies over project assets.

8. Tax

8.1 Withholding Tax

Interest payments are subject to withholding tax of 20.42% unless the country of a receiving person has entered into a tax treaty with Japan, in which case the withholding tax may be exempted or reduced in accordance with such tax treaty.

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8.2 Other Taxes, Duties, Charges

The Stamp Duty Act (Act No 23 of 1967, as amended) provides that a loan agreement is subject to stamp duty. The amount of stamp duty varies depending on the amount of the loan evidenced by a loan agreement, and the stamp duty will be JPY600,000 if the amount of the loan is more than JPY500 million.

8.3 Limits to the Amount of Interest Charged

Japanese usury law, the Interest Restriction Act (Act No 100 of 1954, as amended), restricts the amount of interest that can be charged. Under that Act, a loan of JPY1 million or more shall not charge interest at the rate more than 15% per year and default interest at the rate of more than 21.9% per year. For the purposes of that Act, any amount that has the substance of interest shall be deemed as interest, no matter how it is labelled, and it is considered that a commitment fee to be charged on a revolving credit facility would fall within interest. Such issue is addressed by enactment of the Act on Specified Credit Commitment Contract (Act No 4 of 1999, as amended), where a commitment fee will not fall within interest for the purposes of the Interest Restriction Act if the relevant revolving credit is granted to an entity that satisfies certain requirements; eg, a *kabushiki kaisha* with stated capital of JPY300 million or more, or with net worth of JPY1 billion or more.

As such, since a project company is sometimes so thinly capitalised that it may not satisfy the requirements under the Act on Specified Credit Commitment Contract, it is not uncommon that a commitment fee is not charged to that project company in respect of the availability of any project finance facility at all or until a first drawdown is made, lest that the Interest Restriction Act should be violated.

9. Applicable Law

9.1 Project Agreements

Project agreements are typically governed by Japanese law. A PFI/PPP agreement or concession agreement with the Japanese government is always governed by Japanese law. Fuel supply agreements with a foreign supplier in power projects – eg, conventional power projects and biomass projects – may be governed by foreign law, such as English law or New York law.

9.2 Financing Agreements

Financing agreements are always governed by Japanese law, except that a security document of collaterals located outside Japan would be governed by the laws of the jurisdiction where those collaterals are located.

9.3 Domestic Laws

As described above, project agreements and financing agreements are, with few exceptions, governed by Japanese law.