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Project Finance 2021

Japan: Law & Practice
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JAPAN

Law and Practice

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1. PROJECT FINANCE PANORAMA

1.1 Sponsors and Lenders

The major players differ slightly depending on the type of project.

- Conventional private finance initiative (PFI) projects (ie, availability-based accommodation projects): these are occupied by domestic players, with international players rarely seen. General construction companies and real estate developers are active as sponsors, while Japanese regional banks are active as lenders.
- Concession projects: the above trends for conventional PFI projects are also seen in concession projects, except that Japanese trading companies are more active and, in the case of airport concessions, international airport operators are also active. Japanese major banks typically take the lead in organising syndicates of Japanese banks, but non-Japanese financial institutions sometimes participate in projects in which international sponsors are involved.
- PFI/PPP projects: a unique characteristic of PFI or public-private partnership (PPP) projects in Japan is that local companies in the region where the project is located are often invited to hold a minority interest in the project company as an expression of the sponsors' eagerness to contribute to the local economy. As such, it is not uncommon for a project company to have up to ten or more shareholders.
- Power projects: Japanese trading companies, public power utilities and other domestic and international developers are active as sponsors in power projects, particularly renewable projects. Japanese banks are dominant as lenders.
- Project finance: in Japan, project finance is dominated by Japanese banks. There is very limited space for non-Japanese financial institutions. Project bonds are also uncommon in this market.

1.2 Public-Private Partnership Transactions

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

Against that background, the PFI Act was amended in 2011 to introduce a concession scheme, under which a concessionaire is authorised to collect a commission, toll, fee or other consideration from the general public for their use of the infrastructure that the concessionaire operates. In this way, the concession scheme is considered a flexible tool for structuring a project, where the private sector assumes all or part of the revenue/demand risk. Concession schemes were intended to be used to privatise the operation of certain infrastructure in which the legal title cannot be transferred to the private sector due to national security or other political reasons. The first infrastructure targeted 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 privatised under concession schemes.

The national government is considering privatising other infrastructure using concession

schemes, such as water facilities, stadiums and hydropower plants.

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

In addition to the general PFI/PPP regimes under the PFI Act, the Port and Harbour Act (Act No 218 of 1950, as amended) provides for a PPP regime applicable to specific public property.

1.3 Structuring the Deal

The Japanese project finance market has some unique characteristics. Understanding these characteristics will help in procuring project finance in Japan. Perhaps the most unique characteristic is that the structuring of project finance in Japan is largely influenced by asset finance – real estate finance in particular. 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) investments in project finance are both concepts imported from real estate finance practice.

Bankruptcy Remoteness

The bankruptcy remoteness of a project company is satisfied if:

- the project company is a *godo kaisha* (GK), which is one of the possible corporate forms of a company in Japan and is described further below;
- the GK's only legal equity holder is an *ippan shadan hojin* (ISH), which is a form of legal entity for non-profit organisations;
- the ISH is independent from the project sponsor; and
- all relevant persons (generally, contractors, suppliers and offtakers) waive the right to file in an insolvency proceeding against the GK.

An ISH is considered independent from the project sponsor if all equity interests in the ISH are held by an independent accounting firm and if the corporate officer positions of the ISH are all assumed by accountants who are independent of the project sponsor. Usually, an ISH is incorporated with nominal funding, such as JPY100,000. Furthermore, GKs, ISHs and their respective officers need to deliver to project finance lenders a "non-petition letter" undertaking not to file in any insolvency proceeding with respect to the project company. By doing so, project finance lenders seek to make the project company as remote as possible from legal insolvency proceedings.

TK Investments

TK investment plays an important role in relation to an ISH's involvement in the ownership structure of the GK project company. As the GK project company is held by an ISH that is independent of the 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 investments are employed for that purpose as a substitute for legal equity in the GK. A 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 business as pre-agreed with the TK Investor, sharing the profit

generated from such business with the TK Investor. The business is conducted in the name of the TK Operator, and the TK Investor's liability is limited to the obligation to make an investment of a pre-agreed amount, which means that a 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 the TK Investors are members of the company. Under a TK contract, the profit and loss allocated to TK Investors is directly recognised by the TK Investors, instead of the TK Operator. The effect of this allocation is that the project revenue is not subject to corporate tax at the project company level.

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

1.4 Active Industries and Sectors

Offshore wind projects have been attracting the attention of the market in light of the Japanese government making public statements strongly promoting renewable energy to achieve a carbon-neutral society by 2050.

With respect to integrated resorts (ie, a combination of facilities where a casino is the central and key component facility surrounded by other facilities such as hotels, amusement facilities and convention centres), Yokohama City was widely believed to be one of the most promising candidate cities but dramatically cancelled its plan to establish an integrated resort after a mayoral candidate who was opposed to the plan won the mayoral election on 22 August 2021. Nevertheless, integrated resorts are still attracting the attention of the market. Osaka, another promising candidate city as the site of an integrated resort, selected its private-sector partner through a tender process and has started to prepare a joint proposal, aiming to submit it to the national government by the end of 2021. Under the Act on Development of Specified Complex Tourist Facilities Areas (Act No 80 of 2018), cities interested in developing an integrated resort are to select private-sector partners (including casino operators) and submit a joint proposal to the national government. At the end of the process, the national government will select up to three winning proposals from all of the joint proposals submitted. Financial institutions are exploring ways of providing finance for construction costs by way of project-based finance.

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 law.

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

Mortgages (Teitoken)

A mortgage is available for real estate, automobiles, vessels, aircraft and some other assets. The Japanese government has established and administers a title registration system for

each such asset, and perfection of title is made through registering the title in the government-operated title registration system. Mortgages are also perfected through the title registration system.

There are also special types of mortgage:

- a factory mortgage (*kojo teito*) for mortgages over factories; and
- a factory foundation mortgage (*kojo zaidan teito*), which is for mortgages over the foundation that owns a factory (*kojo zaidan*).

Where a factory mortgage is created over the site of a factory, the security interest extends to the equipment and facilities used for the factory on that site, provided 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 the leasehold of the site and intellectual property.

Pledges (Shichiken)

A pledge is available for any property. However, as far as project finance is concerned, pledges are not typically used for real estate or other tangible property (ie, movable property), and are only used for intangible property such as receivables, bank accounts, insurance proceeds, shares in a company or other forms of equity interests, copyrights and patents, etc. The most relevant reason for only using pledges for intangible property in project finance is that if a pledge is created over real estate or movable property, the owner of the real estate or movable property is deprived of the right to occupy, hold and use such property, which means that the project company cannot occupy, hold or use its real estate or personal property if a pledge is created over such property.

The way to perfect a pledge varies, depending on the type of property over which the pledge is created. A pledge created over a receivable is perfected upon:

- written acknowledgement of the pledge by the debtor of the receivable with a date-certifying stamp of a notary public; or
- written notice from the pledgor of the pledge to the debtor with a date-certifying mail.

The same methods of perfection apply to pledges over bank accounts and over insurance proceeds, because a bank account is considered as a depositor's receivable against the bank and a claim for insurance proceeds against an insurance company is also considered as receivable against the insurance company. As an alternative 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. This saves a great deal of cost and time compared to obtaining written acknowledgement from each debtor of those receivables or sending written notice to each debtor. Other pledges are perfected as follows:

- a pledge created over a share in a company that issues share certificates is perfected upon delivery of the share certificate representing such share;
- a pledge created over a share in a company that does not issue share certificates is perfected upon recording the pledge in the shareholder ledger of that company;
- a pledge created over a share in a listed company is perfected upon recording the pledge in the share transfer recording system administered by the Japan Securities Depository Centre, Incorporated (JASDEC); and

- a pledge created over intellectual property is perfected upon registration of the pledge under the registration system administered by the Japan Patent Office.

Collateral (Joto Tampo)

Collateral assignment is 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 often used to complement pledges, as collateral assignment does not deprive the owner of the property of the right to hold and 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 was made. Collateral assignment of receivables is perfected in the same manner as a pledge. Collateral assignment of movable property and receivables can also be perfected by way of registering the collateral assignment 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 may be granted by a project company to project finance lenders with respect to the contractual position that the project company holds under a contract. Just as with other security interests, the option is structured to become exercisable upon the occurrence of an event of default or acceleration of debt and, if the option is exercised, the project company must transfer its contractual position under that contract to any person that is designated by the lenders (including themselves). Such arrangement is referred to as a "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' so-called "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 floating charges or any 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 the registration of the creation of a security interest. In the case of a mortgage over 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, the 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 must be individually identified in the security document, as registration is made on each property.

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

2.5 Restrictions on the Grant of Security or Guarantees

Under Japanese law, the proceeds of third-party liability insurance cannot be taken as security.

Distinctions between Security/Guarantee Categories

It is also useful to understand the distinctions between the security/guarantee categories in Japan. Under Japanese law, each of the above-mentioned three forms of security interest (mortgage (*teitoken*), pledge (*shichiken*) and collateral assignment (*joto tampo*)) and guarantees are classified into one of two types:

- ordinary security/guarantee (*futsu tampo/hosho*); or
- revolving security/guarantee (*ne tampo/hosho*).

The former is to secure identified specific obligations (eg, term loans), while the latter 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, etc). Once the obligations secured by a revolving security/guarantee are fixed (ie, crystallised), the revolving security/guarantee becomes an ordinary security/guarantee.

Revolving Securities/Guarantees and Mortgages

Revolving securities/guarantees were invented and developed through practice and later ratified by case law. While a revolving mortgage (*ne teitoken*) was codified thereafter, revolving pledges (*ne shichiken*) and revolving collateral assignments (*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 fully tested by the Japanese courts with respect to all of these aspects of a revolving mortgage.

There is another issue related to revolving mortgages. As is the case with an ordinary mortgage (*futsu teitoken*), the value of the 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 a project. At the same time, the rate of registration tax (*torokumenkyo zei*) depends on such amount. Therefore, the value of the obligations secured as registered must be agreed between the project finance lenders and project sponsors prior to registration.

2.6 Absence of Other Liens

There are a number of types of statutory liens under Japanese law. 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 checking the title registration records. For other statutory liens, lenders have no means to confirm whether they exist, other than by checking with the potential parties to such lien.

2.7 Releasing Forms of Security

Generally, security interests automatically cease to have an 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 a revolving security interest/guarantee because the revolving security interest/guarantee is not necessarily extinguished when the outstanding secured obligations are discharged in full.

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. This is called an "event of default" or "event of acceleration" (*kigennorieki soshitsujiyu*). Some of these events or circumstances automatically accelerate repayment of the loans, while others only accelerate repayment of the loans if the lender so notifies the borrower.

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

In order to enforce a right, in general, the holder of the right must obtain a court judgment (or arbitration award if arbitration is the agreed method of dispute resolution) and then present it to the court for execution. However, in the case of enforcing security, the secured interest-holder only has to prove the existence of the security by way of presenting an executed security agreement and/or the relevant perfection documents to the court. The secured interest-holder does not have to obtain a judgment that the debt secured is due and payable, and not yet discharged. Once the existence of the security interest is proved, it is the debtor that owes the burden of proof to show that the debt is not due or otherwise is not required to be paid. When the application for enforcement of a security interest is filed with the court, the court will usually hold a public auction in which the collateral will be sold to the highest bidder and the security interest-holder will receive the net proceeds from the sale of the collateral.

Security interests can be enforced outside of a court, provided that the process of so enforcing the secured interests is agreed and set out in a security agreement. It is standard practice in a Japanese financing transaction to set out the following in a security agreement:

- the right of a secured party to dispose of secured property and apply the proceeds to the secured claim; and
- the right to appropriate the secured property at its appraised value.

It is generally considered that secured interests can be more promptly enforced and greater value realised from the enforcement if the enforcement is conducted out of court rather 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) controls conflict of laws issues in Japan, and allows parties to a contract to choose the jurisdiction governing the contract. Accordingly, the courts of Japan generally uphold the choice of foreign law provision in a contract. However, under this Act, if a court finds that the 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. Furthermore, Japanese laws and regulations covering certain areas – eg, antitrust law, foreign exchange law, labour law, usury law and real estate lease law – are considered mandatory, and will therefore apply regardless of any choice of foreign law.

The Code of Civil Procedure (Act No 109, 1996, as amended) provides that the parties

may choose a court in a foreign country as the agreed venue of dispute resolution. Accordingly, the courts of Japan generally recognise a choice of foreign court made in a contract. However, the Code of Civil Procedure also provides that a choice of foreign court will not be upheld if the Japanese court decides that such court in a foreign country does not have the capability (legally or otherwise) to exercise the jurisdiction of that foreign court.

3.3 Judgments of Foreign Courts

As Japan is a member state of the New York Convention, an arbitral award would be recognised by the 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 it satisfies a certain set of requirements set out in Article 118 of the Code of Civil Procedure. Such requirements include 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 judgment 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. All other documents to be filed with the Japanese court must also be in Japanese or be accompanied by a Japanese translation.

Furthermore, where a foreign lender who does not have any presence in Japan files a claim with a Japanese court, the Japanese court would likely order the foreign lender to place a security deposit with the court to cover the 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 a 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 in Japan.

Whether granting a loan is conducted as business for the purpose of this Act is a fact-oriented issue. Thus, care must be taken if a project sponsor seeks to inject equity into the project company by way of extending a subordinated loan, as it is often considered that if a person extends a loan more than once, such person is deemed to engage in the money-lending business for the purpose of this Act. If such project sponsor has 20% or more of the shares in the project company, then such project sponsor's extension of loans to such project company would be exempted as intra-group financing. If the project sponsor's share is less than 20%, however, due to the above prevailing view, such project sponsor effectively cannot use subordinated loans as a means of injecting equity. In such a case, bonds (*shasai*) with a subordination clause would typically be employed as a substi-

tute for subordinated loans, as subscribing for a bond is not considered to be money-lending for the purpose of this Act.

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

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

4.3 Foreign Investment Regime

The foreign investment regime under the Foreign Exchange and Foreign Trade Act (Act No 228 of 1949, as amended) was reformed to further promote sound investment into Japan and to appropriately monitor investment into Japan that may undermine national security. The new rules have been in effect since June 2020.

In general, the following foreigners are only required to file ex post facto notification to the Bank of Japan, unless the subject company conducts business in a "Designated Industry":

- those who have acquired a share in an unlisted company or 1% of shares in a listed company; or
- those who have provided finance of JPY100 million or more by way of extending a loan or subscribing for a bond with a term of one year or more to a company that has resulted in 50% or more of such company's outstanding debt with a term of one year or more being owed to such investors.

Designated Industry is divided into "Core Industries" and "Non-Core Industries". In general, a Core Industry is an industry that is closely connected to national security and/or fundamental infrastructure such as manufacturing firearms, aircraft or spacecraft, or that is related to electricity, telecommunications, oil or gas, while a Non-Core Industry is an industry other than a Core Industry that is still considered to be important from a national security perspective and/or fundamental infrastructure, such as broadcasting, or is related to biological products, or marine or air transportation.

Where the subject company conducts business in a Designated Industry, the foreign investor may not make the investment unless the foreign investor makes a prior notification and the specified waiting period expires; such period is generally 30 days. This is typically shortened to two weeks but may be extended up to five months, at the discretion of the government. Also, the waiting period will be shortened to five business days if an investment falls within one of the following categories:

- the incorporation of a wholly owned subsidiary in Japan or the acquisition of equity or debt in a wholly owned subsidiary in Japan, or the opening of a branch in Japan (each a so-called "greenfield investment");
- the acquisition of additional equity in a Japanese company without the foreign investor changing its shareholding in the Japanese company and with no change in the management structure of the Japanese company, within six months from the most recent acquisition of equity in the Japanese company by the foreign investor of which notification was made to the minister (a so-called "rollover investment"); or
- the acquisition of equity or debt in a Japanese company as a passive investor having no voting rights on material management matters regarding the Japanese company (a so-called "passive investment").

If it determines during the waiting period 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 the investment, or cancel it. If the investor does not respond to the warning or expresses an intention to disobey the warning, the government may issue an order to change the terms of the investment, or cancel it. Enforcement by a foreign lender of its security interests over any shares in a Japanese company that conducts business in a Designated Industry may also be restricted by such regulations.

On the other hand, the new rules have introduced an exemption from the above prior notification requirement.

First, certain financial institutions (eg, banks, security brokers, insurance companies and fund managers) that are adequately regulated in their home countries are fully exempted from the prior notification requirement.

Second, foreign investors that are not a foreign state or a state-owned enterprise (excluding sovereign wealth funds and public pension funds certified by the Ministry of Finance of Japan) and do not have a criminal record are exempted from the prior notification requirement in the following circumstances:

- in the case of investment in a company that conducts business in a Non-Core Industry:
  - (a) those foreign investors and their related persons will not assume the office of director or internal surveillance officer (*kansayaku*) of the company to be invested in and its affiliates;
  - (b) those foreign investors, as shareholders of the company to be invested in, will not propose or cause to be proposed any disposition or abolishment of the business conducted by the company to be invested in at any shareholder meeting of the investor company; and
  - (c) those foreign investors will not access sensitive technology information held by the company to be invested in; and
- in the case of investment in a company that conducts business in a Core Industry:
  - (a) those foreign investors do not acquire 10% or more of the total voting rights of the company to be invested in;
  - (b) those foreign investors will not participate in any board of directors meetings or any other high-level decision-making body of the company to be invested regarding Core Industry business;
  - (c) those foreign investors will not submit a written proposal to the board of directors or any other high-level decision-making body of the company to be invested in setting a deadline for their response or reaction regarding Core Industry business; and
  - (d) those foreign investors satisfy the above three requirements that apply to investment in a company that conducts business in a Non-Core Industry.

Furthermore, companies in certain regulated industries are subject to a nationality requirement under the respective industry regulations. In this case, generally, a prescribed shareholding majority of such companies must be owned by Japanese citizens and/or Japanese corporations, and this requirement must be fulfilled in order to obtain and maintain a licence for such company to conduct its business. Examples of such companies are 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). If a foreign lender places security interests over shares in such a company, the foreign lender may only enforce the security interests 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 a cross-border payment of more than JPY30 million, unless such payment is made in connection with the international trade of goods.

Under Japanese tax law, the payment of dividends, interest on loans or profit generated from TK investments are all subject to withholding tax of 20.42%, unless the country of the 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 any local formalities in order to be valid or enforceable, except that certain security interests have to be registered in order to be perfected (such registration would require the disclosure of the basic terms of the obligations secured by the security – eg, amount and interest rate).

5.2 Licence Requirements

In general, no licence is required to own land in Japan. This also applies to foreign entities, unless a foreign entity engages in the real estate brokerage business.

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

The concepts of agency and trust are both recognised in Japan. In particular, the Trust Act (Act No 108 of 2006, as amended) clarifies that creating a security trust is permissible. However, due to some practical reasons, security trusts are 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 each time a lender disposes of its shares in a syndicated facility, a new lender has to perfect the acquisition of certain security interests and guarantees. In relation to this, an ordinary security interest/guarantee is tagged with, and carries the loans secured by such ordinary security interest/guarantee by operation of law. On the other hand, a 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 with each other, priority will be determined based on when 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 of enforcement proceeds, secured lenders typically enter into an intercreditor agreement. However, a Japanese court would not uphold such intercreditor agreement in a foreclosure proceeding and would distribute enforcement proceeds to secured

lenders in priority of the time that the security interests were perfected and in accordance with the relevant statutes that determine the priority between the security interests and any other statutory liens. After the distribution of such proceeds is made by the court, the secured creditors who received such proceeds and are parties to the intercreditor agreement are obliged by contract to redistribute such proceeds so that the secured creditors will receive the enforcement proceeds as contemplated by the intercreditor agreement.

5.5 Local Law Requirements

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

As a matter of practice, it is extremely rare for a project company to be a foreign-law corporation; the typical form of a project company is a *kabushiki kaisha* or a *godo kaisha*.

6. BANKRUPTCY AND INSOLVENCY

6.1 Company Reorganisation Procedures

Under Japanese law, there are four types of insolvency proceedings:

- bankruptcy proceedings (*hasan tetsuzuki*);
- special liquidation proceedings (*tokubetsu seisan tetsuduki*);
- civil rehabilitation proceedings (*minji saisei tetsuduki*); and
- corporate reorganisation proceedings (*kaisha kosei tetsuduki*).

Of these four types of insolvency proceedings, civil rehabilitation proceedings and corporate reorganisation proceedings are reorganisation-type procedures; the other two are liquidation-type proceedings. Special liquidation proceedings and corporate reorganisation proceedings are only available to a *kabushiki kaisha*.

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

Corporate reorganisation proceedings are a reorganisation-type procedure where a reorganisation trustee (*kosei kanzainin*) appointed by the court operates and protects the debtor's business and property.

6.2 Impact of Insolvency Process

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

However, the commencement of any insolvency proceedings other than corporate reorganisation proceedings does not prevent secured creditors from enforcing their security outside the insolvency proceedings and recovering their loans from the enforcement proceeds of the collateral. In contrast, under corporate reorganisation proceedings, secured creditors are not allowed to enforce their security. Project finance lenders preferring bankruptcy remoteness therefore

require the project company to be a *godo kaisha*, as corporate reorganisation proceedings are only available against a *kabushiki kaisha*.

6.3 Priority of Creditors

In the case of insolvency proceedings other than corporate reorganisation proceedings (ie, civil rehabilitation proceedings, bankruptcy proceedings or special liquidation proceedings), while secured creditors may recover their outstanding loans from the 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 the enforcement proceeds of the collaterals. Proceeds from the disposition of the debtor's general assets are 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.

Debts under certain subordination agreements are treated as subordinated under the respective insolvency proceedings. Where a sponsor injects equity by way of subordinated debt or TK investment, project finance lenders usually ensure that the subordinated debt or TK investment agreement contains a clause that produces a similar effect to subordination agreement-type arrangements in relation to any claims regarding such injected equity.

6.4 Risk Areas for Lenders

A debtor that has become insolvent is unlikely to have sufficient assets to discharge all of its outstanding debts, in which case creditors that do not have sufficient security would typically end up writing off their loans. Those creditors may try to obtain some of the debtor's assets as security to secure their priority on those assets, but such action is capable of being avoided under any subsequent insolvency proceedings as being an impermissible preference.

Corporate reorganisation proceedings are generally considered unfavourable to secured creditors in that the secured creditors are not allowed to enforce their collateral until the approved reorganisation plan is fully implemented, and the reorganisation plan may write off their loans and/or reschedule the repayment of their loans.

6.5 Entities Excluded from Bankruptcy Proceedings

No private entities are excluded from insolvency proceedings in Japan. However, governments and local municipalities are considered excluded from insolvency proceedings.

7. INSURANCES

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

In general, foreign insurance companies are not allowed to provide insurance to Japanese residents for property located in Japan or vessels or aircrafts registered in Japan unless they open a branch office in Japan and obtain a license under the Insurance Business Act (Act No 105 of 1995, as amended), with the following exceptions:

- reinsurance;
- marine insurance;
- aircraft insurance;
- spacecraft insurance;
- international cargo insurance; and
- overseas travel insurance.

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 the person receiving the interest 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.

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 which varies depending on the amount of the loan evidenced by the loan agreement. 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

The Interest Restriction Act (Act No 100 of 1954, as amended), which is the main source of usury laws in Japan, restricts the amount of interest that can be charged. Under this Act, for a loan of JPY1 million or more, interest at a rate of more than 15% per year and default interest at a rate of more than 21.9% per year may not be charged. For the purposes of this Act, any amount that in substance is charged like interest is deemed to be interest, no matter how the amount may be described. Furthermore, this Act states that any commitment fee to be charged on a revolving credit facility will fall within the definition of interest. This created difficulties in the corporate finance sector and was therefore specifically addressed by the enactment of the Act on Specified Credit Commitment Contracts (Act No 4 of 1999, as amended), under which a commitment fee is deemed not to fall within the definition of interest for the purposes of the Interest Restriction Act if the relevant revolving credit is granted to an entity that satisfies certain requirements – eg, the entity is a *kabushiki kaisha* with stated capital of JPY300 million or more, or with net worth of JPY1 billion or more.

However, in practice, since a project company is sometimes so thinly capitalised that it may not satisfy these requirements under the Act on Specified Credit Commitment Contract, to avoid violating the Interest Restriction Act it is relatively common for a commitment fee not to be charged to a project company in respect of the availability of any project finance facility at all, or until a first drawdown is made.

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, a local municipality or a state-owned entity is always governed by Japanese law. However, fuel supply agreements with a foreign supplier in power projects (eg, conventional power projects and biomass projects) are sometimes governed by foreign law, such as English law or New York law.

9.2 Financing Agreements

Financing agreements are always governed by Japanese law, with the exception that security agreements on collaterals located outside Japan would typically be governed by the laws of the jurisdiction where those collaterals are located.

9.3 Domestic Laws

As described in **9.1 Project Agreements** and **9.2 Financing Agreements**, project agreements and financing agreements are governed by Japanese law, with only a few exceptions.

Nagashima Ohno & Tsunematsu is one of the foremost providers of international and commercial legal services based in Tokyo. The firm has more than 520 lawyers, including 40 experienced foreign attorneys from various jurisdictions. 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, Europe, North and South America and other regions. The firm regularly advises leading power utilities, trading companies and investors on their energy projects, including all associated regulatory matters. It also advises financial institutions on financing for these projects. The firm has dealt with a number of renewable power projects since the introduction of the feed-in tariff in Japan.

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