NAGASHIMA OHNO & TSUNEMATSU
長島・大野・常松 法律事務所

# NO&T Japan Legal Update

March, 2022 No.31

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## INTERNATIONAL TRADE AND COMMERCE, AND ECONOMIC SANCTION

### Japan's Economic Sanctions against Russia

#### I. Introduction

In light of the current conflict between Russia and Ukraine, the Japanese government has implemented various economic sanctions against Russia based on the Foreign Exchange and Foreign Trade Act of Japan (the "Foreign Exchange Act"). Japan's economic sanctions have been implemented in concert with many western industrialized countries and regions (such as the US, the EU and the UK), and consist of, among others, import/export restrictions, the freezing of assets of certain individuals and entities, and a prohibition on issuing or circulating certain securities.

This article outlines the sanctions against Russia introduced by the Japanese government up to March 21, 2022.

#### II. Export and Import Control

(i) Export Restrictions

On February 26, March 1, March 3, and March 8, 2022, the Cabinet of Japan approved the introduction and expansion of export prohibitions under the Foreign Exchange Act. Based on those approvals, the Export Trade Control Order (subordinate legislation of the Foreign Exchange Act) was amended with effect as of March 18, 2022. Under the amended Export Trade Control Order, the following exports are generally prohibited unless an export license is granted[1]:

1 According to guidance published by the Japanese government, such exports are, in principle, not permitted except for certain exceptional cases, such as (i) export of foods and medicines, consumer communication equipment, and communications infrastructure for the private sector, (ii) export for the purpose of providing human aid , ensuring cyber security, ensuring the safety of the oceans, (iii) exports between governments, and (iv) where the final user is an entity whose shares are entirely held by persons in Japan or certain western countries.

## Authors in this Issue

■ INTERNATIONAL TRADE AND COMMERCE, AND ECONOMIC SANCTION

**Makoto Ohnuma**
Partner
+81-3-6889-7195
makoto_ohnuma@noandt.com

**Axel Kuhlmann**
Foreign Law Partner
+81-3-6889-7240
axel_kuhlmann@noandt.com

**Nanoka Hayakawa**
Associate
+81-3-6889-7593
nanoka_hayakawa@noandt.com

■ GLOBAL INVESTIGATIONS / CRISIS MANAGEMENT / COMPLIANCE

**Tomohiro Hen**
Partner
+81-3-6889-7248
tomohiro_hen@noandt.com

■ FINANCE

**Yoshimune Muraji**
Partner
+81-3-6889-7586
yoshimune_muraji@noandt.com

(a) export of items to Russia and Belarus that are subject to multilateral export control regimes (e.g., machine tools, carbon fibers, high-performance semiconductors);

(b) export of goods to certain organizations related to Russia and Belarus (including the Russian Ministry of Defense, Russian aircraft manufacturers, and other military-related organizations);

(c) export to Russia and Belarus of certain multi-purpose goods (e.g., semiconductors, computers, telecommunications equipment) that are considered to contribute to reinforcing Russia's military capabilities;

(d) export to Russia of equipment for refining petroleum; and

(e) export to the so-called "Donetsk People's Republic" and "Luhansk People's Republic" ("Donetsk and Luhansk").

(ii) Import Restrictions

Under the Import Trade Control Order (subordinate legislation of the Foreign Exchange Act) and a related government notice, it is prohibited to import goods originating from Donetsk and Luhansk as of February 26, 2022.

## III. Asset Freezing

The Japanese government has also applied asset freezing measures to certain designated individuals and entities related to Russia, Belarus, or Donetsk and Luhansk. The list of designated individuals and entities has been expanded several times since first being published on February 26, 2022. Since then the following entities and individuals have been newly designated ("Sanctioned Parties"):

- 34 entities related to Russia and Belarus (including the Central Bank of the Russian Federation and VTB Bank);
- 95 individuals related to Russia and Belarus (including the Russian President, the Belarusian President, and certain number of oligarchs); and
- 54 individuals affiliated with Donetsk and Luhansk.

Under the asset freezing measures, the following acts may not be carried vis-à-vis the Sanctioned Parties unless with permission by the Japanese government (provided that the prohibitions will become effective only as of March 28, 2022):

(a) any payment to the Sanctioned Parties; and

(b) any capital transaction with the Sanctioned Parties (such as deposit, trust, or loan agreements) .

## IV. Other Economic Sanctions

In addition to the measures mentioned above, the following economic measures have also been imposed by the Japanese government:

(i) Restrictions on securities transactions

(a) Issuance and offering of securities
The new issuance or offering of securities by the government of the Russian Federation, and other government agencies designated by the Japanese government (collectively, the "Russian Government") in Japan are prohibited unless prior permission is obtained from the Minister of Finance.

(b) Acquisition and transfer of securities
The acquisition by residents of Japan from non-residents, or the transfer by residents of Japan to non-residents, of securities that are newly issued by the Russian Government is prohibited unless prior permission is obtained from the Minister of Finance.

(c) Provision of security-related services
The provision by residents of Japan of services or benefits for the purpose of the issuance or offering of securities by the Russian Government in Japan is prohibited unless prior permission is obtained from the Minister of Finance or the Minister of Economy, Trade and Industry.

(ii) Prohibition of the issuance of securities in Japan by certain Russian banks

Certain designated Russian banks are prohibited from issuing or offering securities in Japan with a maturity over 30 days.

The Japanese economic sanctions are based on a complex system of subordinate legislation and governmental notices under the Foreign Exchange Act. The sanctions have been constantly amended and tightened almost on a daily basis. Depending on how the situation will develop, additional sanctions against Russia in alignment with Western countries can be expected. Businesses operating in Japan would be well-advised to keep abreast of any new developments and how the current and future economic sanctions may affect their business.

**GLOBAL INVESTIGATIONS / CRISIS MANAGEMENT / COMPLIANCE**

**Whistleblowing Systems Required by the Amended Whistleblower Protection Act**

## I. Introduction

The importance of robust internal whistleblower systems has been highlighted recently in Japan with a number of large-scale corporate misconduct being identified through whistleblowing reports. Since one of the most important aspects of corporate crisis management is to detect and rectify compliance incidents as soon as possible, establishing an effective whistleblowing system is crucial for many, if not all, business operators. Against this background, on June 12, 2020, a partial amendment (the "Amendment") to the Whistleblower Protection Act (the "Amended Act") was promulgated. The objective of the Amendment is to strengthen the protection of whistleblowers and facilitate more proactive reporting. The Amendment will take effect on June 1, 2022. While the Amendment has a wide scope, two areas of particularly importance are (i) the mandatory[2] establishment of internal systems to enable business operators to appropriately respond to public interest whistleblowing reports[3], and (ii) the designation of persons responsible for responding to public interest whistleblowing reports.

## II. Mandatory Establishment of Internal Systems to Enable Business Operators to Appropriately Respond to Public Interest Whistleblowing Reports

Article 11 (2) of the Amended Act requires business operators to establish internal systems and take other measures necessary to respond appropriately to public interest whistleblowing reports. According to the guidelines issued for the appropriate and effective implementation of measures to be taken by business operators pursuant to Article 11, Paragraphs 1 and 2 of the Whistleblower Protection Act (the "Guideline"), those systems and measures are largely divided into three elements (i) systems to respond to whistleblowing reports across divisions and departments, (ii) systems to protect whistleblowers, and (iii) measures to ensure the effective function of the whistleblowing systems.

### (i) Systems to Respond to Whistleblowing Reports Across Divisions and Departments

A business operator shall (i) establish an internal whistleblowing contact (the "Contact") and clearly specify the departments and persons in charge of receiving whistleblowing reports from the Contact, conducting investigations, and taking the necessary measures to rectify the misconduct specified in the whistleblowing report; (ii) take measures to ensure independence in cases where management is suspected of having involvement in the reported misconduct; (iii) conduct necessary investigations unless there are justifiable grounds not to commence an investigation; and (iv) take measures not to involve persons who are related to the case and to eliminate any conflicts of interest.

### (ii) Systems to Protect Whistleblowers

A business operator shall take measures to prevent disadvantageous treatment against whistleblowers, including, but not limited to, taking disciplinary action or other appropriate measures when disadvantageous treatment occurs. A business operator shall also develop systems to prevent employees and officers from sharing information contained in whistleblowing reports outside of the necessary scope and shall take appropriate remedial and restorative measures in the event of improper information sharing.

### (iii) Measures to Ensure the Effective Function of the Whistleblowing Systems

A business operator shall (i) provide education and training regarding the Amended Act and whistleblowing systems to employees, officers and retirees, (ii) in cases where a whistleblower report is received in writing, promptly notify the whistleblower of the remedial measures implemented to address the reported facts, to the extent that doing so does not hinder the proper execution of business and the protection of the confidentiality, credibility, reputation and privacy of the parties involved, (iii) take measures concerning the retention, review and improvement of whistleblowing records, and the disclosure of the operating results of the whistleblowing systems. Additionally, the elements required to be taken by the Guideline

2 Business operators with 300 or less employees on a regular basis are only obligated to make an effort to meet those requirements.
3 Public interest whistleblowing reports mean whistleblowing reports that fall under the category of Public Interest Whistleblowing Report provided for in Article 3, Item 1 and Article 6, Item 1 of the Amended Act.

shall be reflected in a business operator's internal rules and the business operator shall operate in accordance with those rules.

## III. Designation of Persons Responsible for Responding to Public Interest Whistleblowing Reports

Article 11 (1) of the Amended Act requires business operators to designate a person (the "Designated Person") to receive whistleblowing reports, conduct investigations into the reported facts, and engage in initiatives to implement remedial measures to address the results of the investigations[4]. If in the course of their work, the Designated Person becomes aware of certain information that would allow them to identify the whistleblower, the Designated Person becomes subject to a strict duty of confidentiality, which, if violated, would subject the Designated Person to potential criminal penalties composed of a monetary fine of not more than JPY 300,000. The introduction of such a duty of confidentiality can be regarded as a major revision in Japanese practice and, thus, it is necessary to include in the internal rules that the business operator shall clearly notify the Designated Person of their duties and obligations.

Notwithstanding the above, under Article 12 of the Amended Act, disclosure by the Designated Person of the protected information does not constitute a violation of the duty of confidentiality if there is a "justifiable reason" for such disclosure. It can be reasonably assumed that there would be a "justifiable reason" in cases where the whistleblower has given his or her consent, or where information is shared with persons who require such information for the purpose of conducting the investigation.

## IV. Comments

While many business operators may have already established an internal whistleblowing system, the introduction of the Amended Act and the Guideline is a timely reminder for business operators to review their internal practices. As the whistleblowing system constitutes an extremely important part of a company's compliance system, it is important for each business operator to examine its specific arrangements by referring to the Amended Act and the Guidelines to ensure its processes are compliant and in line with best practice.

4 Business operators with 300 or less employees on a regular basis are only obligated to make an effort to appoint a Designated Person.

**FINANCE**

**Loan Refinancing in Japan by way of Amendment and Restatement**

## I. Introduction

Refinancing can be a good option for parties seeking to gain improved terms and conditions of existing loan arrangements. For example, in order to achieve a better gearing ratio and partial return of capital, a borrower of the project financing of a power plant might consider refinancing for the purposes of lowering the interest rate and the required DSCR after a certain period of time following the commencement of the operation given that the risk profile of the operational phase is different from the development phase.

For the refinancing of syndicated loans, which involves changing some of the syndicate members, some may be familiar with the amendment and restatement ("A&R") method used in other jurisdictions where the parties and terms and conditions of the existing loan agreement are changed globally and only the increased portion of the loan (if any) is newly extended without the repayment of the existing loan. Despite certain economic benefits of the A&R approach, it has not been widely adopted in the Japanese banking sector. Instead, it is more common to see a traditional physical refinancing approach with the existing loans repaid in full at the same time as the extension of new loans and replacing the original financing documents with new financing documents. This article summarizes the practical characteristics and matters to be considered when adopting the A&R approach to refinancing in Japan.

## II. Why the A&R Approach is Preferable

There are a number of reasons why the A&R approach is more preferable than the traditional physical refinancing. Below are four of the most common:

### (i) Saving of mortgage registration tax

If a mortgage has been given to the lenders under the existing loans, the same is often required by the refinancing lenders. Since the registration tax for the transfer of an existing mortgage is lower than the registration of the establishment of a new mortgage[5], the A&R approach can be more cost efficient.

### (ii) Avoiding break-funding costs

A borrower is usually required to pay break-funding costs to the lenders when the repayment of loans is made on a date other than an interest payment date of the existing loans. That means that the borrower will only be able to refinance at a date which coincides with the interest payment dates – typically three or six months. Under the A&R approach, to the extent that the loan amount after the A&R refinancing is larger than the existing loan amount, no physical repayment of the loans would occur and thus no break-funding costs would be payable. This gives the borrower additional timing flexibility when refinancing.

### (iii) Maintaining capitalized costs

As an accounting matter, certain borrowers may have capitalized the initial financing costs depending on their previous transactions. Unlike under traditional physical refinancing, capitalized costs can be maintained under the A&R approach since the existing loan facility will continue to exist notwithstanding a change to the group of lenders or certain amendments to the financing documents.[6]

5 Registration of the establishment of mortgage: 4/1,000 for a real estate mortgage, 2.5/1,000 for a factory foundation mortgage (based on the loan amount to be registered).
Transfer of the existing mortgage: 2/1,000 for a real estate mortgage, 1.5/1,000 for a factory foundation mortgage (based on the registered amount and not the remaining balance; thus a borrower may want to reduce the registered amount to the amount of the remaining balance before the application for registration of transfer).

6 It is recommended to closely consult with accounting and tax advisers when considering A&R refinancing.

(iv) Efficient negotiations

In contrast to traditional physical refinancing where the scope of amendment to the existing terms and conditions is unlimited and the scope of negotiations could be extensive, under the A&R approach, parties would naturally prefer to maintain the existing terms and conditions to the extent that they are not relevant to the purposes of the refinancing. From a legal point of view, any amendment that could result in a change in the identity of the loans should be avoided in order to maintain the existing security interests. Therefore, taking the A&R approach could greatly enhance the efficiency of negotiations by focusing only on the purpose of the refinancing itself, and save time and costs for all parties.

## III. Why the A&R Approach is not Common in the Japanese Market

Despite the advantageous points mentioned above, the A&R approach is not generally adopted in Japanese market for the following reasons:

(i) Individual loan transfer required

Under the A&R approach, to the extent that the contemplated refinancing involves a change in the syndicate members, loans will be transferred from existing lenders, whose participation will decrease, to other lenders, whose participation would increase upon the refinancing.

Under the Japanese Civil Code (Act No.89 of 1896, as amended), a sale and purchase (*baibai*) must be made between an individual seller and an individual purchaser in respect of the exact portion that is to be sold and purchased. Thus the parties have an additional burden to specify each seller and its corresponding purchaser and the amount of the loan to be transferred between each seller and purchaser in the A&R agreement. The settlement method of the sale and purchase price should also be considered as the payment from the purchaser should be made to the corresponding seller in principle.

(ii) Security created for individual lenders

In some jurisdictions because security is given to a single entity such as the security trustee instead of each individual lender, the transfer of the loans of an individual lender would not necessitate a security transfer depending on how the security is structured. However, under Japanese law it is established market practice that an individual security interest is created for each individual lender.[7] Consequently:

(a) A conservative and practical interpretation of the perfection method of creating a pledge over contractual rights (which is typically given to the project financing lenders regarding the borrower's contractual rights under the project documents) would be that it is necessary to obtain a consent letter again from the counterparty to the applicable contract to perfect the pledge after the A&R refinancing. Therefore, under such interpretation, the A&R approach would not necessarily simplify the refinancing process.

(b) Any increased portion or other new loan (if any) must be secured by a newly created individual security interest that is separate from the security interests created in favor of the existing lenders. Since the priority order of the security interest is determined based on the timing of the perfection, if the parties intend to make the order of priority across the existing and new security interests the same, it would be necessary to change the priority of the already perfected security interests. In this respect, while there is a statutory provision for such change in the order of priority for mortgages (*teitou-ken*)[8], other kinds of security interests including pledges (*shichi-ken*) do not have a similar statutory mechanism and there is no established interpretation on how to effectuate such change.[9]

7 Security trust is legally achievable under the Japanese Trust Act (Act No. 108 of 2006, as amended); however, it is not widely used due to certain practical reasons.

8 Article 374 of the Civil Code.

9 As a matter of contract, parties may agree on changes in the order of priority of security interests other than a mortgage. However, such agreement may not be honored in a Japanese court if the security is foreclosed. If parties are to make such an agreement, they should also consider whether to include an equalization clause under which the proceeds from the foreclosure of the securities are

(iii) Unfamiliarity

As the A&R approach has not been widely used in the Japanese market, some lenders may require more time to evaluate the transaction. Since the A&R agreement will involve all the existing and new lenders[10], the borrowers and the refinancing arrangers also have the task of obtaining the understanding of all the related parties.

## IV. How to Achieve A&R Refinancing

The A&R approach remains a practical and preferable option in certain circumstances. Entities interested in adopting the A&R approach would be well advised to keep the following points in mind.

(i) Agreement on individual loan transfers

An A&R agreement will list the details of the individual loan transfers including each seller, purchaser and the amount to be transferred between each seller and purchaser. The settlement of the sale and purchase price will be made collectively through a paying agent appointed by each purchaser.[11]

The risks concerning the repayment of the loan itself should be borne by the borrower in the same manner as in traditional physical refinancing, including conditions precedent to the A&R agreement, representations and warranties, events of default and similar standard provisions.[12]

(ii) Re-establishment of security interests excluding those concerning registration tax

Considering the legal and practical factors described in Section III (ii) above, instead of taking a universal approach across various kinds of security interests, parties can take different approaches to how mortgages and other security interests are managed. This means that, on the one hand in respect of a mortgage, parties can have the registered mortgage transferred from one lender to another and, if a new mortgage is established, create and register that new mortgage and implement the change in the order of priority under the aforementioned statutory mechanism in the Civil Code. On the other hand, as there is no similar mechanism for other security interests, parties may elect to cancel the existing security interests first and then re-establish new security interests in favor of each of the continuing and new lenders after the A&R refinancing and follow the perfection procedures anew.[13]

## V. Additional Considerations

There are several other points to be considered and documented when A&R refinancing is implemented. For instance, as the A&R structure requires the participation of all the existing and new lenders, further consideration

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shared by the existing lenders, who the court has determined has the higher priority ranking and who actually receives the proceeds, with the new lenders who the court has determined has the lower priority ranking. Under this arrangement, the new lenders assume part of the credit risk of the existing lenders. However, this remains a practical option to the extent that the new lenders consider that (i) in-court foreclosure is a highly unlikely scenario, and (ii) it is also a highly unlikely situation that an existing lender receives the enforcement proceeds while it is insolvent and it goes bankrupt before it delivers the enforcement proceeds in accordance with the equalization provision.

10 All the retiring lenders are required to be party to the A&R agreement since they are the transferor lenders. All of the remaining lenders are also required to be party to the A&R agreement since it typically involves matters that require all lenders' consent under the existing financing documents, such as the repayment of loans to only a part of the lenders and lowering the interest rate.

11 It is not common for the existing agent to serve as the paying agent of a lender in respect of its sale and purchase transaction under the financing documents. Thus the A&R agreement needs to provide the authorization by each purchaser to the agent to make the payment of the purchase price to the corresponding seller.

12 Theoretically, a transferee lender of the existing loan may bear the risk that a bankruptcy or rehabilitation proceeding is commenced with respect to the transferor lender after the A&R refinancing and the transfer is avoided (*hinin*) by a bankruptcy trustee (*hasan kanzai-nin*) or other administrator. However, to the extent that the transferor lender is a bank, such transferee lender should generally be able to consider that the practical risk is low and the legal requirements for a bankruptcy trustee or other administrator having rights of avoidance to effect an avoidance of a transaction that is conducted for a "reasonable value" (*soutou no taika*) are generally not easily met. Generally, it must be established that (i) the actual risk that the debtor would conceal, gratuitously convey or otherwise dispose of the property in a manner prejudicial to bankruptcy creditors existed, (ii) the debtor intended to carry out such disposition, and (iii) the other party had been aware of such debtor's intent.

13 Re-establishment of the security interests would be accompanied by an avoidance (*hinin*) risk unlike the transfer of the security interests which is irrelevant to the borrower's solvency. However, such risk would also be present in traditional physical refinancing and is not unique to A&R refinancing.

may need to be given to what options are available if one or more of the retiring lenders rejects the A&R refinancing proposal. Managing the existing interest rate swap is also another area that requires careful consideration. Entities considering adopting an A&R approach to refinancing are recommended to take into account all the practical benefits and risks under the Japanese legal system and market practice in the Japanese banking sector

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NAGASHIMA OHNO & TSUNEMATSU www.noandt.com

JP Tower, 2-7-2 Marunouchi, Chiyoda-ku, Tokyo 100-7036, Japan
Tel: +81-3-6889-7000 (general) Fax: +81-3-6889-8000 (general) Email: info@noandt.com

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