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Japan

PROJECT FINANCE

Contributor

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This country-specific Q&A provides an overview of project finance laws and regulations applicable in Japan.

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JAPAN

PROJECT FINANCE



1. What are the typical ownership structures for project companies in your jurisdiction? Does this vary based on the industry sector?

The typical ownership structure is to establish a stock company (kabushiki kaisha) or a limited liability company (godo kaisha) as a project company to hold the project, whereby sponsor holds equity interests in the project company.

2. Are there any corporate governance laws or accounting practices that foreign investors in a project company should be aware of?

Corporate governance of a stock company or a limited liability company is regulated by Companies Act (Act No. 86 of July 26, 2005). Generally, the Companies Act is less restrictive on a limited liability company in terms of corporate governance than on a stock company. In case of a stock company, depending on the size of the company, there is a mandatory and additional corporate structural requirement under the Companies Act, such as to appoint an accounting auditor and to have an internal control system in place.

3. If applicable, what forms of credit support from sponsors or host governments are typically provided?

Sponsors typically provide shareholder's loan aside from injecting equity investment into the project company.

4. What types of security interests are available (and suitable) for a project financing in your jurisdiction?

Typically, a security package provided for a project financing includes: a mortgage/lien over the project company's title or right to use the project site, lien over

the equipment or other movables used for the project, pledge over the project company's bank accounts used as project accounts, pledge over the project company's claim for insurance payment, pledge over the project company's contractual title or claims under the project agreements to which the project company is a party, sponsor's equity interest in the project company.

5. How are the above security interests perfected?

Securities over claims or contractual title/rights are generally perfected by obtaining consent letter from the third parties on which a certified date stamp shall be affixed by notary public office.

Securities over the sponsor's equity interest are perfected by registration in shareholder's list or handing over share certificate, depending on whether the project company is share certificate issuing company (where the project company is a stock company) or obtaining consent letter issued by the project company with certified date stamp (where the project company is a limited liability company).

6. Please identify how security is enforced (notably the enforcement options available for secured parties) both pre and post insolvency/bankruptcy of the project company?

(1) Pre insolvency/bankruptcy of the project company

In general, secured party is entitled to (i) enforcement of security interests by applying for the enforcement procedures by court set out in the Civil Execution Law (minji-shikkou-hou) and (ii) (if the relevant security agreement provides) out-of-court enforcement.

Enforcement of security interests under the Civil Execution Law depends on the asset type of the collateral provided as security. If the collateral is real property or movables, generally the enforcement is

public auction held by the court. If the collateral is claims against the third parties, the enforcement is the seizure of the claims followed by collection of the claims or acquisition of the claims by the secured party.

Under the out-of-court enforcement, options available to the secured party are set forth in the relevant security agreement. Under the Japanese common practice, parties normally set forth the options available to the secured party broadly to include secured party's entitlement (a) to sale of the collateral and application of the proceeds to the secured claims, (b) to accord and satisfaction and (in case of claims) (c) to direct collection of the claims from the third party obligor.

(2) Post insolvency/bankruptcy of the project company

Under certain type of the insolvency/bankruptcy procedure, whether the process is in or out of court, each creditor's security enforcement is prohibited and the secured creditor receives payment pursuant to the plan promulgated by the court-appointed-trustee. Other types of insolvency/bankruptcy procedure allows Security Interest holder to individually exercise of enforcement of security interests under the Civil Execution Law.

7. What are other important considerations in relation to the security regime in the jurisdiction that secured parties should be aware of?

As mentioned above in question number 5, securities over claims or contractual title/rights are generally perfected by obtaining consent letter from the third parties. Sometimes, especially such contractual right is a lease right against local land owner, such owner may not be aware of the entire picture of the project in which the relevant land is involved, and there may be some difficulty and hence it may take substantial time to explain why the land owner or other third party obligors are requested to provide consent letters and to obtain consent letters from them. This needs to be factored in when considering the timeline for the financing and the entire project.

8. What key project risks should lenders be aware of in project financings in your jurisdiction? This may include, but may not be limited to, the following risks: force majeure, political risk, currency convertibility risk, regulating or permitting

risk, construction/completion risk, supply or feed stock risk or legal and regulatory risk).

We understand key components of risks in project financing in Japan do not largely differ from them in other major jurisdiction, which include construction risk (time overrun and cost overrun), increase in project operation and maintenance, supply risks (increased cost of supply and materials), social and environmental risks (protest by local residents around the project site, especially if the project causes environmental issues, local government may not be supportive on the project), force majeure (especially, natural disaster including typhoon and earthquake), legal and regulatory risk (e.g. changes in local regulation) and foreign currency exchange risk (especially exchange rate fluctuations).

9. Are any governmental / regulatory consents required and are any financing or project documents requirement to be filed with any authority in order to be admissible in evidence in a court of law, valid or enforceable?

There is no such rule of evidence in Japan.

10. Are there any specific foreign exchange, royalties, export restrictions, subsidies, foreign investment, that are relevant for project financings (particularly in the natural resources sectors)?

Foreign Exchange and Foreign Trade Act (Act No. 228 of December 1, 1949) regulates foreign investment in certain industries from the perspective of national security. Industries subject to the regulation include energy, waterworks, communication, broadcasting, railways, route buses, coastal shipping, petroleum, leather, footwear, agriculture, forestry, and fisheries. The manner of regulation depends on the jurisdiction of the investor and the industry, however, the typical situation is when foreign investor acquires equity interest in Japanese entities engaged in these area of industries, the investor is required to make prior or post notification of such acquisition and if it is prior notification requirement, the investor must wait certain days' waiting period before the acquisition is implemented.

11. Please set out any specific environmental, social and governance

issues that are relevant. For example, are project companies subject to certain ESG laws, reporting requirements or regulations?

ESG laws in Japan provide reporting obligation to companies which include project companies when they conduct certain activities or when they fall under certain situations. The examples of activities or situations requiring reporting are, business operators whose annual energy consumption (crude oil equivalent) of their factories is 1,500 kl or more are required to submit mid-term or long-term plan for capital investment, etc. pertaining to energy conservation to the government, business operators emit certain large amounts of greenhouse gases as a result of business activities are required to report volume of greenhouse effect gas to the government, and companies which handle a certain category of chemical substance must report to the government the volume and other required information on the substances they use.

12. Has any public-private partnership models or laws been enacted in the jurisdiction, and if so, are they specific to certain industry sectors?

Act on Promotion of Private Finance Initiative (Act No. 117, 1999) has been enacted and governs public-private partnership model projects in Japan. Industries which may be implemented as public-private partnership model are specifically listed under the Act which include:

- (1) Public facilities such as roads, railways, ports, airports, rivers, parks, waterworks, sewerage systems and industrial water supply systems;
- (2) Public facilities such as government buildings and housing;
- (3) Rental housing and educational and cultural facilities, waste disposal facilities, medical facilities, social welfare facilities, relief and rehabilitation facilities, parking lots and underground shopping centers;
- (4) Information and communication facilities, heat supply facilities, new energy facilities, recycling facilities (excluding waste disposal facilities), tourist facilities and research facilities; and
- (5) Transportation facilities such as ships and aircraft and artificial satellites (including facilities necessary for the operation of these facilities)

13. Will foreign judgments, arbitration awards and contractual agreements to arbitrate be upheld?

Judgments of a foreign court or arbitration awards may be upheld and enforced in a court in Japan, without further consideration of the merits of the case, if all the following conditions are fulfilled:

- (a) the foreign judgment concerned is final and conclusive;
- (b) the foreign court has jurisdiction pursuant to Japanese laws or treaties to which Japan is a party concerning the rules of jurisdiction;
- (c) service of process has been lawfully effected on the relevant defendant other than by public notice or other similar service, or the relevant defendant appeared in the relevant proceedings without receiving service thereof;
- (d) neither the foreign judgment nor the procedures to obtain such judgment is contrary to public policy and good morals in Japan;
- (e) judgments of Japanese courts receive reciprocal treatment in the courts of the foreign jurisdiction concerned; and
- (f) the dispute resolved by the foreign judgement has not been resolved by a judgement given by a Japanese court and is not being litigated before a Japanese court;

Contractual agreements to arbitrate will be upheld in Japan.

14. Is submission to a foreign jurisdiction and waiver of immunity effective and enforceable?

Generally submission to a foreign jurisdiction and waiver of immunity are effective and enforceable.

15. Please identify what you consider to be (a) the key current issues for project financing in your jurisdiction; and (b) any emerging trends or topics which should be considered or focused on by project financing stakeholders.

- (a) key current issues

Historically Japan has not been a large market for project

finance. In 2010s Japan has introduced feed-in tariff which increased a number of renewable energy projects and project finances. Also, amendment to Act on Promotion of Private Finance Initiative in 2015 which introduced concession scheme in PFI facilitated formation of PFI projects in respect of public facilities. Japan do not hold natural resources to the extent competitive in the global market both in terms of quantity and variety, hence the number of projects and project finance are mostly focused on energy and public infrastructure, leaving the other areas immature as a market for project financing.

(b) emerging trends or topics

As for the increase of projects in renewable energy area, solar power plant project has been most vigorous and major type of energy source in the area. However, recently it is anticipated by market participants that next leading source of energy will be offshore wind power generation. National and local government have been implementing a number of projects as well as providing legal framework for offshore wind power projects and a lot of key players from inside or outside Japan have started acting in this market. Because Japan is for some years or decades behind in this energy sector compared to other foreign countries or jurisdiction such as Europe, major players often take advantage of their knowledge and experience to be more competitive than Japanese emerging competitors in the Japanese market.

16. Please identify in your jurisdiction what key legislation or regulations have been implemented (or will / plan to be) for projects in connection with the energy transition?

The most significant legislation implemented in the past few decades is Act on Special Measures Concerning Procurement of Electricity from Renewable Energy Sources by Electricity Utilities (Act No. 108 of 2011) enacted in 2011 which introduced feed-in tariff system in renewable energy sector. This legislation improved renewable energy projects dramatically both in quantity and quality and also invited massive number of investors from inside and outside Japan. As for the solar power generation, with the passing of the years, and purchase price of generated electricity getting lower in each year, formation of new solar power generation projects is not as intense as the past years, however, the “secondary market” where project owners who hold projects with higher FIT price selling the project still remains active.

Recently, since law amendment in 2017, purchase price of solar power generated electricity produced by more

than certain size of power plant is subject to and determined through bid. Also, implementation of FIP (Feed in Premium) system aiming to provide more flexibility in the determination of purchase price of renewable energy has started in 2022.

17. Please identify if there are any material tax considerations which need to be taken into account for a project financing in your jurisdiction, and if so, how such tax issues can be mitigated.

Normally project company is subject to corporate tax and also dividend payment to its equity holder is subject to another corporate/income tax. Whether to attempt to mitigate this double tax issue is one of the key considerations in structuring the project. For example, if a limited liability company (godo kaisha) is selected as a project company (please refer to #1) and the investor makes investment via tokumei kumiai investment under Commercial Code of Japan, if properly structured, the amount of profit to be paid to the investors under tokumei kumiai investment will be treated as financial loss of the project company, thereby in substance removing taxation at the project company level.

18. What types of funding structures (e.g. debt, equity or alternative financing) are typical for project financing in your jurisdiction. For example, are project bond issuances, Islamic finance and - in the context of mining deals - streams or royalties, seen as attractive (and common) options for stakeholders?

Typical funding structure in Japan is lender(s) to provide debt financing and sponsor(s) to provide equity funding or shareholder loan to project company.

19. Please explain if there are any regional development banks or export credit agencies, and if so, what is their role in project financing in your jurisdiction and beyond.

Development Bank of Japan Inc., which is 100% government owned financial institution is acting as regional development bank, and one of their major role is to provide loans and investments to support projects with high policy characteristics such as project finance, PFI, business revitalization, ventures, industry-academia-

government collaboration, international cooperation, and social and environmental activities.

20. Please explain if there are any important insurance law principles or considerations in connection with any

project financing in your jurisdiction.

Under the Insurance Act (Law No.56 of 2008) of Japan, establishing pledge over the insurance claims for the liability insurances is prohibited, and parties carve out such insurance claims from the scope of insurance claims provided as a pledge in favour of lenders.

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