

CORPORATE / INTERNATIONAL TRADE LAW BULLETIN

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A Lookback on Foreign Investment Regulations in Japan in 2022

- I. FDI Screening under FEFTA
- II. New Law on Sensitive Lands
- III. Economic Security Promotion Act

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Neighboring China and Russia and being a close ally of the United States, 2022 was another year for Japan to tackle geopolitical challenges and national security issues.

Among the many aspects of the Japanese policies on national security, this issue will focus on the developments in foreign investment regulations in Japan in 2022, and also tries to provide some insights for 2023.

I. FDI Screening under FEFTA

In 2022, there has been no substantive amendment to the FDI (foreign direct investment) screening framework under the Foreign Exchange and Foreign Trade Act of Japan (the "FEFTA"). Also, following [the overhaul of the FEFTA in 2020](#), the Japanese government is yet to block a single transaction. As a result, the attempted acquisition of 20% shares of J-Power (Electric Power Development Co.,Ltd., a wholesale electric utility owning a nuclear power plant) by The Children's Investment Fund in 2008 is still the only transaction blocked in history.

However, the scrutiny by the authorities is becoming ever stricter. Behind the scenes, there have been transactions that were called off by foreign investors partly because of the negative prospects of the clearance under the FEFTA. Also, among the transactions successfully cleared, we are seeing an increasing number of cases where the foreign investors were required to agree to mitigation conditions such as a commitment not to access any confidential technology information of the Japanese issuer.

According to statistics released by the Ministry of Finance in June 2022¹, there were 2,859 prior notifications made in FY2021, 54% of which were related to cybersecurity-related industries (which widely include software and SaaS businesses), which is a more than 30% increase from 2,171 in FY2020. However, a simple comparison cannot be made because the amended FEFTA was implemented in June 2020 and the scope of the notifiable transactions are different before and after it. Also, when looking at the number of prior notifications closely, you will notice that 513 out of

¹ [Number of Prior Notification relating to Foreign Direct Investments \(FY 2021\)](#)

CORPORATE / INTERNATIONAL TRADE LAW BULLETIN

the 688 increased cases account for notifications made in connection with exercise of voting rights (e.g., appointment of a closely related person of a foreign investor as director of a Japanese issuer) and the number of prior notifications made in connection with acquisition of shares may not have increased proportionately.

The amendment of the FEFTA in 2020 expanded the scope of the notifiable transactions including by lowering the notification threshold for acquisition of listed shares from 10% to 1%, but concurrently introduced exemptions from the prior notification requirements which are available for passive investors. The statistics seems to suggest that the effect of the expansion of the notifiable transactions might have been largely offset by the introduction of the exemptions.

In practice, foreign investors have widely relied on these exemptions, regardless of whether the relevant Japanese issuer is listed or unlisted. In response, the Ministry of Finance and other competent ministries are strengthening ex-post monitoring of the use of exemptions. They are monitoring to ensure that (a) the foreign investor who carried out an FDI in reliance on any exemption is entitled to rely on the relevant exemption (e.g., any state owned enterprise cannot rely on any exemption as its investment could cause national security concerns), and (b) such foreign investor has been in compliance with the relevant exemption conditions (which are conditions to make sure that the foreign investor remains a passive investor and must be always complied with following the relevant FDI, and include, for example, covenants not (i) to appoint any closely related person of the foreign investor as director of the Japanese issuer, (ii) to propose divestiture of the business designated as sensitive to national security, and (iii) to access confidential technology information of the Japanese issuer).

As part of such ex-post monitoring, in 2022, the Ministry of Finance and other competent ministries widely disseminated a set of questions to foreign investors who used the exemptions asking them to answer within about two weeks regarding their compliance with the exemption requirements.

II. New Law on Sensitive Lands

The Act on the Review and Regulation of the Use of Real Estate Surrounding Important Facilities and on Remote Territorial Islands (the "Important Land Review Act"), which aims to review the ownership and use of lands around remote border islands and defense-related facilities, and to impose certain regulations when necessary, came into full effect on September 20, 2022. Unlike the FEFTA, the Important Land Review Act does not discriminate foreign investors and is applicable to Japanese residents equally, but it does affect land acquisition activities in Japan by foreign investors.

Under the Important Land Review Act, certain areas will be designated as "watch zones" and may be subject to review, use restrictions, or purchase by the government.

CORPORATE / INTERNATIONAL TRADE LAW BULLETIN

In addition, areas in the watch zones that are particularly important or vulnerable and are indispensable will be designated as “special watch zones”, and prior notifications will be required before execution of any sale and purchase agreement with respect to any land in the special watch zones.

Designation of the watch zones and special watch zones will be made after listening to the opinions of the Council on the Use of Real Estate, which has already discussed candidate sites for the initial designation of these areas. Based on such discussion, it is expected that the initial designation of the areas will be made by the end of 2022. Because the initial list of the watch zones and special watch zones will likely be very short and limited, and we expect it to be rare for this Act to be an issue in M&A transactions.

III. Economic Security Promotion Act

The Act on the Promotion of National Security through Integrated Economic Measures (the “Economic Security Promotion Act”), promulgated on May 18, 2022, is a statute with multiple agendas: stable supply of critical materials, stable provision of critical infrastructure, support for development of advanced technologies, and introduction of a secret patent system. Among these, the framework for the stable provision of critical infrastructure introduces a prior notification and screening framework similar to the FDI screening framework under the FEFTA.

The target critical infrastructure businesses will be designated from among the 14 sectors of electricity, gas, oil, water, railroads, freight forwarding, ocean freight, aviation, airports, telecommunications, broadcasting, postal services, financial services, and credit card businesses. The competent ministers will then designate from among the providers of such critical infrastructure businesses those who own critical facilities the failure of which will likely result in harm to national security.

When such designated provider of a critical infrastructure business intends to install a critical facility or outsource its maintenance or operation, the designated provider will be required to submit a written plan to the competent minister for examination in advance (in principle, 30 days from the receipt of the submission, with a maximum extension of 4 months).

The competent minister will examine whether or not there is a risk that the critical facility will be used as a means to obstruct the stable provision of services related to the critical infrastructure from outside Japan if the plan is implemented, and if the minister concludes that there is a significant risk (e.g., the critical facility to be purchased from a foreign company is found to be installed with unauthorized software that could be used by the foreign company or foreign government behind it for the purpose of obstructing the stable provision of services related to the critical infrastructure), then the minister will

CORPORATE / INTERNATIONAL TRADE LAW BULLETIN

have the authority to recommend or order suspension or amendment of the plan.

A foreign business company operating in the 14 sectors should continue paying close attention to the development on this framework as it can directly impact its business. Also, a foreign business company which plans to acquire a Japanese target with a plan to have its products or services installed at the Japanese target will need to evaluate during the deal process whether this new framework could be an obstacle in achieving such plan.

The relevant provisions of the Economic Security Promotion Act will be implemented in phases, with the target companies to be designated during 2023 (within one year and six months after promulgation), while the provisions regarding prior notification and examination will likely come into effect in 2024 (within one year and nine months after promulgation).

PUBLICATIONS

- Book "Comprehensive Analysis of M&A Laws of Japan – Second edition"
Publication Yuhikaku Publishing Co., Ltd.
Author Mori Hamada & Matsumoto
- Article "Security Clearance Systems in the U.S. and Japan and a New System Similar to Security Clearance that is Being Discussed in Japan"
Publication CISTEC Journal
Author Shintaro Okawa
- Article "Foreign Exchange and Foreign Trade Act and Activists - Countermeasures that can be Taken by Japanese Corporations Against Activists Under the Foreign Exchange and Foreign Trade Act"
Publication Commercial Law Review
Author Shintaro Okawa
- Book "China's Digital Strategy and Laws - Current Status of China's Information Laws and the Future of Digital Society"
Publication KOUBUNDOU Publishers Inc.
Author Shigehiko Ishimoto and Yoshifumi Onodera

CORPORATE / INTERNATIONAL TRADE LAW BULLETIN

NEWS

- [Mori Hamada Matsumoto to start strategic business alliance with ATD Law in Jakarta from January 2023](#)

Mori Hamada & Matsumoto is pleased to announce a business alliance with ATD Law in Jakarta, a newly established Indonesian firm, starting from January 2023. ATD Law begins its operations today as an independent Indonesian law firm.

- [Notice of Nagoya Office Relocation](#)

With effect from December 12, 2022, we will relocate our Nagoya Office from the 23rd Floor to the 29th Floor of the Dai Nagoya Building.

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*Telephone and fax numbers will remain the same.

- [High evaluation received from "Who's Who Legal: Global Guide 2022"](#)

Our lawyers have been selected as Leaders in their respective practice areas by Who's Who Legal: Global Guide 2022.

- Arbitration

Future Leader: Daniel Allen

- Capital Markets – Debt and Equity

Global Leader: Katsumasa Suzuki, Taro Omoto, Masakazu Kumagai, Toshimitsu Nemoto and Tony Grundy

- Capital Markets – Structured Finance

Global Leader: Masanori Sato

- Competition

Thought Leader – Global Elite: Kenji Ito

Thought Leader: Hideki Utsunomiya

Global Leader: Kana Manabe and Yusuke Takamiya

Future Leader: Aruto Kagami

CORPORATE / INTERNATIONAL TRADE LAW BULLETIN

- Data – Information Technology

Global Leader: Yoshifumi Onodera and Masakazu Masujima

- Data – Data Security

Global Leader: Masakazu Masujima

- Insurance & Reinsurance

Global Leader: Masakazu Masujima

- M&A and Governance – M&A

Global Leader: Gaku Ishiwata, Atsushi Oishi and Yuto Matsumura

- M&A and Governance – Corporate Governance

Global Leader: Gaku Ishiwata

- Private Funds - Formation

Global Leader: Yasuzo Takeno and Ken Miura

- Project Finance

Global Leader: Hiroshi Maeda

- Real Estate

Global Leader: Masanori Sato, Eriko Ozawa and Masahito Saeki

- Telecoms Media & Entertainment – Telecoms & Media

Global Leader: Yoshifumi Onodera

- Trade & Customs

Global Leader: Yusuke Takamiya

- Transport– Space & Satellites

Global Leader: Daiki Ishikawa

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