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Law and Practice

Contributed by Mori Hamada & Matsumoto

Contents

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1. Loan Market Panorama

1.1 The Impact of Recent Economic Cycles and the Regulatory Environment

Under the Abe administration, accommodative monetary policy has bolstered financial institutions' lending appetite. Competitive market dynamics have also put downward pressure on interest rates and lending fees.

Borrowers are therefore benefiting from easy access to debt financing. Capital expenditure of Japanese companies increased for five consecutive years until 2016. M&A, infrastructure projects and the real estate market have also been active. The value of outstanding loans held by Japanese banks exceeded JPY485 trillion at the end of 2017, compared to JPY478 trillion at the end of 2016.

1.2 The High-yield Market

Given the relatively wide availability of senior facilities provided by banks, the role played by high-yield facilities has been somewhat limited. However, high-yield and mezzanine debt remain popular for borrowers seeking to stretch debt capacity in structured transactions such as leveraged buyouts and real estate acquisitions. Mezzanine debt is typically provided in the form of subordinated loans or preferred shares.

1.3 Alternative Credit Providers

Banks and other conventional financial institutions continue to play a central role in the Japanese loan market. The most sizeable among them are three mega banks (Mizuho, MUFG, SMBC), which, together with Resona and Resona Saitama, account for 38.7% of the outstanding loan balance as of the end of 2017, down from 40.8% as of the end of 2015. Other players include non-bank money lenders, private investment funds and government-related financial institutions.

1.4 Evolution of Banking and Finance Techniques

The fintech movement is gathering pace in the Japanese market. Start-up firms and conventional financial institutions are seeking to make fundamental changes to almost all aspects of finance. In the context of lending and investment, crowd-funding, social lending and transaction lending are prime examples, all of which seek to match investors with borrowers who have not previously had access to conventional finance.

1.5 Recent or Expected Legal, Tax, Regulatory or Other Developments

The law is catching up with the fintech movement. The Banking Act, the Payment Service Act and other financial regulations had to be amended to accommodate these new fintech services.

Other than that, the amendment to the Civil Act (contract law) was passed by the Diet in May 2017 and will come into effect on 1 April 2020.

2. Authorisation

2.1 Requirements for Authorisation to Provide Financing to a Company

A lender who makes a loan in Japan must have a licence under Japanese regulation if that loan is made as part of its money-lending business, subject to certain exemptions (such as intra-group lending). The licence requirement will be satisfied if the lender is licensed as a bank or a Japanese branch of a foreign bank, or registered as a money lender.

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans

Provided that foreign lenders abide by the licence requirement described in **2.1 Requirements for Authorisation to Provide Financing to a Company**, there are no further material restrictions applicable only to foreign lenders. If a foreign lender cannot abide by the licence requirement, it may consider subscribing bonds rather than making loans.

3.2 Restrictions on Foreign Lenders Granting Security

There are no material restrictions on granting security or making guarantees applicable only to foreign lenders. For further information on the enforcement of security interests by foreign lenders, see **6.4 A Foreign Lender's Ability to Enforce its Rights**.

3.3 Restrictions and Controls on Foreign Currency Exchange

The Foreign Exchange and Foreign Trade Act sets out Japanese policy regarding foreign currency exchange. As far as normal international lending is concerned, there are certain post-facto reporting requirements.

3.4 Restrictions on the Borrower's Use of Proceeds

There are no general regulations that restrict the use of loan proceeds. However, with respect to financial institutions, such institutions are regulated under the Criminal Proceeds Transfer Prevention Act, which aims to prevent money laundering and financial support for terrorism activities. To that end, the Act requires financial institutions to:

- undertake know-your-customer procedures before entering into a loan transaction with a borrower;
- create and maintain transaction records; and
- report to the relevant authority if they find suspicious transactions.

Under the recent amendment of the Act, if the borrower is a corporation, financial institutions are required to identify individuals with substantial control over such borrower.

If the loan proceeds are used for money laundering, terrorism or other antisocial activities, it may expose lenders to reputational risks at the very least. To mitigate this risk, the use of proceeds of a bank loan is usually specified in the loan agreement, and misuse thereof would be an event of default. Under standard syndicated loan documentation, the unanimous vote of the lenders is required for the borrower to change the use of proceeds.

3.5 Agent and Trust Concepts

In general terms, Japanese law recognises agent and trust concepts. In practice, administrative agents and security agents are commonly appointed in syndicated loan transactions governed by Japanese law. However, the agents' roles are limited to administrative functions in most cases and parallel debt structures (whereby the parallel debts belong to the agent who holds security interests on behalf of the lenders) are rarely adopted, although such structures are not impossible under Japanese law. The use of security trust structures, whereby the security trustee holds security interests on behalf of the lenders, is also limited, although they are explicitly permitted under Japanese law. In many cases, each of the syndicated lenders holds its security interest on its own behalf and an intercreditor agreement sets out the restrictions on its exercise, such as the enforcement being prohibited in the absence of majority lenders' consent.

3.6 Loan Transfer Mechanisms

The most common transfer mechanism in the secondary loan market is the outright transfer of loan receivables. A loan receivable can be transferred without the borrower's consent unless the relevant loan document provides otherwise. The benefit of the associated security package can be transferred with or without the consent of the security provider and other lenders, depending on the nature of the security interests, such as whether the security interest is a fixed security or a blanket security. Many loan documents oblige the security providers, subject to certain conditions, to co-operate with the secondary transaction by giving consent to the transfer of the security interest.

Another secondary mechanism is loan participation. Under a participation arrangement, the loan receivable and security package does not legally transfer to the participant. As such, the participant benefits indirectly from the security package via the lender's enforcement.

3.7 Debt Buy-back

Japanese law does not prohibit a borrower or sponsor from agreeing with the lenders to buy back its debt. If the borrower buys back its own debt, the debt automatically disappears unless it is provided as collateral in favour of a third party. If a sponsor buys back the debt, the debt obligation

remains outstanding, which creates an issue regarding how to treat the sponsor's share of the debt in the context of syndicate voting. Some syndicate loan agreements address this situation, but many others do not.

3.8 Public Acquisition Finance

Under the Japanese tender offer bid (TOB) regulation, the offeror must be able to demonstrate its ability to fund its tender offer at the launch date. The offeror may satisfy this requirement by submitting a commitment letter provided by a financial institution. The Japanese Financial Services Agency has stated that the commitment letter provided for this purpose must evidence the certainty of funding to a fairly reliable degree. However, no further details of this requirement have been officially announced. In practice, the relevant financial bureau may provide comments on the draft commitment letter before the launch date of the tender offer. Once the final commitment letter has been filed, it becomes available to the public.

Borrowers generally negotiate with the lenders over the conditions precedent to eliminate the uncertainty of funding as much as possible. Lenders and borrowers sometimes agree on so-called "certain funds" terms, although the details may differ on a case-by-case basis. Leveraged public acquisition deals are one of the most typical categories of transaction where these types of terms are negotiated, although such negotiations also occur in the course of private acquisition finance transactions.

4. Tax

4.1 Withholding Tax

A cross-border payment of loan interest by a Japanese borrower to a foreign lender is subject to Japanese withholding tax, subject to certain exemptions. The tax rate is 20.42%, unless an applicable tax treaty provides otherwise.

4.2 Other Taxes, Duties, Charges or Tax Considerations

A written loan agreement is subject to stamp duty. The duty amount differs depending on the amount loaned and the nature of the loan transaction, such as whether the loan is a term loan or a line of credit. The maximum duty amount is JPY600,000 per loan document.

Corporate taxation differs depending on the status of each party. International lenders should note that their Japanese tax treatment changes depending whether the profit relating to the loan arises through their perpetual equipment in Japan or not.

Other taxes and charges that may become relevant to a loan transaction include registration fees and notary fees for the perfection of security interests, and court fees for the commencement of judicial enforcement of security interests.

4.3 Usury Laws

There are usury laws in Japan. Although multiple Acts address this issue in a complex manner, the most notable law is that the maximum interest rate for loan transactions is 15% where the amount loaned is JPY1 million or more.

The usury laws provide that fees or other monies paid to a lender in respect of a loan are deemed to be interest for the purpose of the interest rate cap. In this context, the scope of "deemed interest" often becomes a practical issue. Firstly, under the Commitment Line Act, commitment fees are statutorily exempted from the scope of deemed interest provided that the borrower falls within the prescribed categories, such as a stock corporation with share capital of JPY300 million or more. Secondly, whether other fees such as the arrangement and agent fees fall within the scope of deemed interest has at times been a critical issue. The practitioners' approach to this issue is, put simply, that provided that the independent and substantial services (such as arrangement services) are provided and the amount of fees are within a reasonable range for such services, the fees should not fall within the scope of deemed interest.

5. Guarantees and Security

5.1 Assets Typically Available and Forms of Security

The typical forms of security interest and perfection requirements corresponding to each type of asset are set out below. If the security is not perfected, the lender cannot assert its preferred position vis-à-vis third parties. Such third parties include perfected secured creditors, perfected acquirers of the target's properties and the bankruptcy trustee of the security provider.

Real estate

A mortgage is the most typical form of security for real estate. The secured obligation can be specified (ordinary mortgage; *futsu-teito*) or designated as a certain group of unspecified obligations (blanket mortgage; *ne-teito*).

Lenders register the mortgage at the relevant legal affairs bureau to perfect the mortgage. The registration fee is 0.4% of the amount of secured obligation. To reduce the upfront cost, some lenders permit the borrower to make a provisional registration only, which costs JPY1,000 per property. Once the mortgage is provisionally registered, the mortgagee reserves priority over other mortgagees who register their mortgages after the provisional registration. However, provisional registration is of little use unless formal registration is completed. Therefore, lenders need to ensure that they are always in possession of all documents necessary to allow them to register the mortgage formally.

Movable properties
Pledges and security assignments (i.e. security by way of assignment or assignment for the purpose of security) are the most typical forms of security for movable properties. The secured obligation can be specified or designated as a certain group of unspecified obligations.

To effectuate a pledge over movable properties, actual delivery of the subject properties is required. For this reason, security assignment is more often adopted since actual delivery is not required.

To perfect a security assignment of movable properties, actual delivery or constructive delivery (such as the occupant's manifestation of its intent to occupy the subject assets on behalf of the lenders) of the target properties is required. Alternatively, registration of the transfer will also perfect the security assignment.

Movable properties can be collateralised as individual properties or a pool of properties. The pool needs to be sufficiently identified by specifying the type of asset, the location and other necessary criteria. This method enables the lenders to capture after-acquired movable properties as security.

Receivables
Pledges and security assignments are the most typical forms of security for receivables. The secured obligation can be specified or designated as a certain group of unspecified obligations.

If the collateralised receivables arise from the underlying contract that contains a transfer restriction clause, the receivable cannot be collateralised without obtaining the obligor's consent.

Lenders can perfect the pledge or security assignment by giving notice to, or obtaining consent from, the obligor in written form together with a notarised date certificate. Alternatively, registration of the pledge or transfer will also perfect the pledge or security assignment.

Future receivables can be subject to the pledge or security assignment provided that the target receivables are sufficiently identified and follow other requirements.

Shares
A pledge is the most typical form of security for shares. The secured obligation can be specified or designated as a certain group of unspecified obligations.

Even if the articles of association of the issuer contain transfer restrictions, a share pledge can be effectuated by an agreement between the pledgor and the pledgee. However, lenders sometimes request that the target company amend its articles of association so as not to hinder the enforcement of the pledge, or otherwise to ensure the smooth enforcement of the share pledge.

The perfection method differs depending on the type of shares. If the shares are dematerialised, the pledge is perfected by means of electronic book-entry. If not, the share pledge is perfected by delivery of the share certificate representing the pledged shares. If the shares are not dematerialised and the issuing company does not issue share certificates pursuant to its articles of association, the share pledge is perfected by requesting that the issuing company record the pledge on its shareholder ledger.

Others
Other types of assets – such as debt securities, IP and trust beneficial interests – are taken as security and perfected in accordance with the steps applicable to each type of asset.

5.2 Floating Charges or Other Universal or Similar Security Interests

The concept of a universal security interest (whereby the lender is granted security interest over all the debtor's property, whether present or after-acquired, to secure its secured obligation) is not available to secure loan obligations under Japanese law. Therefore, lenders need to follow the creation and perfection procedure for each type of collateral asset. As mentioned in **5.1 Assets Typically Available and Forms of Security**, future (after-acquired) movable property and receivables can be collateralised to the extent permitted under applicable requirements.

5.3 Downstream, Upstream and Cross-stream Guarantees

There are no specific statutory limitations or restrictions on downstream, upstream and cross-stream guarantees. However, there are often issues in relation to upstream guarantees due to the general fiduciary duty owed by the guarantor's directors. If a subsidiary provides an upstream guarantee solely for the benefit of a majority shareholder (owning less than 100% of the shares in the guarantor) in the absence of the subsidiary's corporate benefit then the directors of the subsidiary will be exposed to the risk of breaching their fiduciary duties. To avoid this risk, in practice, upstream guarantees are often made subject to the consent of any minority shareholders.

5.4 Restrictions on Target

In general, a subsidiary is restricted from acquiring its parent's shares. This restriction is interpreted to be applicable not only in the case where the subsidiary legally acquires its parent's shares, but also to a transaction that results in the economical equivalent result. Theoretically, it is not totally clear whether a target providing financial assistance for the acquisition of its own shares conflicts with such a restriction. However, it is common practice for the acquired target company to grant security or provide a guarantee to secure

the acquisition facilities borrowed by the parent vehicle and partially funded by the sponsor.

If an acquisition vehicle does not acquire 100% of the shares in a target and the target grants security or provides a guarantee in respect of the acquisition then this may give rise to an issue regarding the target director's fiduciary duties. See **5.3 Downstream, Upstream and Cross-stream Guarantees**.

5.5 Other Restrictions

In addition to the general rules explained above, there are some special statutory restrictions in relation to granting security or providing guarantees. For example, granting security over insurance claims arising under liability insurance policy is prohibited. Also, an individual cannot guarantee unspecified loan obligations without specifying the maximum amount of the guarantee.

5.6 Release of Typical Forms of Security

If the secured obligation of a security interest is specified, the security interest disappears upon full payment of the secured obligation by operation of law. If the secured obligations are designated as a certain group of unspecified obligations, the lenders usually need to release the security interest for the security interest to disappear.

5.7 Rules Governing the Priority of Competing Security Interests

The general rule is that the priority among several security interests over an asset is determined by reference to the time at which each security interest is perfected, or the first perfected security is given first priority. Therefore, as a matter of ranking the security interests, subordination can be created in many cases by perfecting the subordinated lender's security after the senior lender perfects its own security.

Regarding some types of assets, there are technical difficulties in creating several security interests with different rankings. For example, theoretically, it is not clear whether there can be several security assignments over one property. Moreover, the book-entry system does not accept multiple pledges over dematerialised shares. In these cases, senior lenders and subordinated lenders agree to contractual subordination or other arrangements to accomplish a similar outcome.

Among unsecured obligations, several methods of subordination are used. Aside from structural subordination (which involves borrowing entities at different levels, where the subsidiary borrows senior debt and the parent borrows subordinated debt), there are two types of contractual subordination structure: absolute subordination and relative subordination.

Under an absolute subordination arrangement, in an insolvency situation, the payment of subordinated debt is conditional on the full payment of the senior debt. Senior lenders thus ensure that the subordinated lender does not receive payment in priority to, or at the same ranking with, the senior lender.

The essence of a relative subordination arrangement is an intercreditor agreement between the senior and subordinated lenders. Typically, the subordinated lenders agree to hand over any payment they receive from the borrower to the senior lenders until the senior debt is paid in full, subject to certain exceptions. This type of arrangement is not intended to be effective vis-à-vis an insolvent borrower.

6. Enforcement

6.1 Circumstances in Which a Secured Lender Can Enforce Its Collateral

The central requirement for a lender to be able to enforce its security interest is that the secured obligation remains unpaid when due and payable. The lender typically declares an acceleration of the entire secured obligation pursuant to the loan agreement if it enforces its security interest before final maturity.

Under standard security documentation, a lender may choose to enforce a security interest created in a commercial transaction by a judicial (in-court) procedure or private (out-of-court) process.

Using judicial enforcement, a lender may enforce a mortgage over real estate by submitting the real estate registration certificate on which the mortgage is registered. Typically, that real estate is then sold to a third party through a judicial auction process and the sale proceeds are applied to the repayment of the secured obligation.

One of the problems with judicial enforcement is that the sale proceeds are likely to be substantially lower than would be realised through a private auction. A lender should therefore consider selling the subject property out of court, or acquiring the subject property by itself at fair value and discharging the secured obligation by the same amount.

6.2 Foreign Law and Jurisdiction

Japanese courts generally recognise the validity of a choice of a foreign law as the governing law of a contract, but the governing law of security interests cannot be chosen by the parties. For example, security interests over real estate and movable properties are governed by the law of the location of the subject properties.

Japanese courts also generally recognise the validity of a submission to a foreign jurisdiction.

A waiver of sovereign immunity is upheld provided that the waiver is made in compliance with the requirements of the

Act on the Civil Jurisdiction of Japan with respect to a Foreign State.

6.3 A Judgment Given by a Foreign Court

Japanese law adopts the principle of reciprocity regarding the recognition of foreign judgments. As such, Japanese courts will recognise final and conclusive civil judgments rendered by a foreign court provided that:

- the foreign court is deemed to have valid jurisdiction over the matter based on relevant laws or treaties;
- the unsuccessful party received due service of process or appeared in court;
- the content of the judgment and the related court proceedings are not contrary to the public order and good morals of Japan; and
- there exists reciprocal recognition between the relevant foreign jurisdiction and Japan.

Japan is a party to the New York Convention (1958) and the Geneva Conventions (1927). Therefore, to the extent these conventions are applicable, the recognition of a foreign jurisdiction is determined in accordance with these conventions. Otherwise, recognition of a foreign arbitral award is determined based on the same requirements applicable to a domestic arbitral award under the Arbitration Act, which are that (i) the award must be final and conclusive, (ii) the parties must have received due service of process and been afforded the opportunity to defend themselves, (iii) the award must have been given in accordance with the law of the location of the arbitration and (iv) the contents of the arbitral award must not be contrary to the public order and good morals of Japan.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Regarding the enforcement of share pledges, foreign lenders are restricted from acquiring pledged shares over companies that conduct certain limited categories of business related to national security, including telecommunications, broadcasting and aviation.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

As well as judicial insolvency proceedings, private restructuring processes are very important. They are initiated by the borrower's lawyer and sometimes involve a third-party organisation specialising in private turnaround situations.

This type of process is chosen by a financially distressed debtor who would like to avoid the damage that would be caused by the public announcement of a commencement of statutory insolvency proceedings.

Given the private nature of this process, the creditor's rights are not involuntarily impaired and unanimous agreement among major creditors is required for the debtor to implement its restructuring plan.

7.2 Impact of Insolvency Processes

There are three major statutory insolvency proceedings; namely, bankruptcy (*hasan*), civil rehabilitation (*minji saisei*) and corporate reorganisation (*kaisha kousei*). Bankruptcy results in the liquidation of the borrower's business, while the other two proceedings allow the debtor's business to continue once substantial changes have been made to its assets, liabilities and equity pursuant to a rehabilitation or reorganisation plan.

Under statutory insolvency proceedings, creditors of unsecured claims are generally prohibited from enforcing their loans once judicial insolvency proceedings have commenced (and, in most cases, immediately after the insolvency application has been filed with the court) with respect to the borrower. The unsecured creditors must instead recover their claims in accordance with the insolvency procedure, both in terms of the timing and the amount of the recovery. The same applies to the enforcement of a guarantee in the case of insolvency of the guarantor.

The general rules applicable to secured creditors are dependent on which of the three insolvency proceedings is chosen.

Under corporate reorganisation proceedings, secured creditors are prohibited from enforcing their security interests outside the reorganisation proceedings and the secured creditors can receive repayment only in accordance with the reorganisation plan approved in the reorganisation proceedings, both in terms of the timing and amount of the recovery. More than two-thirds of the voting rights held by all secured creditors need to be voted in favour of a reorganisation plan if the plan provides for a rescheduling of the secured claims and more than three-quarters of the voting rights are needed if the plan provides for other restrictions on the security interests (for example, a haircut of the secured portion of the claims held by the secured creditors). The Corporate Reorganisation Act recognises the concept of a 'cram-down' whereby the court may approve a plan without the consent of certain classes of creditors; for example, the secured class of creditors (Article 200-1). However, in order for the court to approve a plan pursuant to a cram-down provision, the court is required to grant fair protection to the objecting class of creditors by, for instance, distributing the fair value of the security interest to the secured claim holders.

Under bankruptcy proceedings and civil rehabilitation proceedings, enforcement of a security interest is, in principle, not affected by the insolvency of the borrower. However, there are notable exceptions to this general rule with regard to civil rehabilitation. First, the court may issue an injunctive order to stop the enforcement of a security interest by

a creditor, to the extent that the injunctive relief would be in the general interest of creditors and that the relevant secured creditor would not suffer unjustifiable damage as a result. Second, the court may approve the extinguishment of security interests where the collateral is essential for the continuance of the debtor's business. However, in order for the extinguishment to be utilised, the debtor is required to pay off the fair value of the collateral to the security holder. The fair value will be determined by the court and the secured creditor may request an expert appraisal if it is not satisfied with the value proposed by the court.

7.3 The Order Creditors Are Paid on Insolvency

Unsecured loans, which include any unsecured portions of partially secured loans, are usually treated as general claims in Japanese insolvency proceedings.

General claims are subordinated to common benefit claims, such as fees to the bankruptcy trustee, and preferred general claims, such as wages for employees and certain tax claims.

On the other hand, general claims have priority over certain subordinated claims, such as accrued interest arising after the commencement of insolvency proceedings.

Regarding secured claims, see **7.2 Impact of Insolvency Processes**.

7.4 Concept of Equitable Subordination

Japanese insolvency legislation does not have a general principle that allows an insolvency court to lower the priority of a claim on the grounds that the claim is held by a controlling shareholder.

7.5 Risk Areas for Lenders

One of the notable risk areas for lenders in statutory insolvency proceedings is the risk of avoidance. The creation of a security interest by a financially distressed borrower may be invalidated (by the insolvency trustee or the debtor-in-possession) if the security interest was created to secure existing debt:

- after the filing of an insolvency petition against the borrower (and the creditor knew that the petition had been filed);
- during the period when the borrower is "unable to pay" (i.e. unable to pay its debts generally when they fall due) and the creditor knew that the borrower was unable to pay, or that the borrower did not pay, its debts generally when they fell due; or
- 30 days or less before the borrower became "unable to pay" and the borrower voluntarily created the security interest in favour of a specific creditor, and the creditor knew that the creation of the security would prejudice other creditors.

The perfection of a security interest may also be avoided even where the creation of security interest itself may not be avoided pursuant to the criteria above. This is to prevent a holder of a security interest that has been hidden for a long time from obtaining priority over general creditors after the borrower becomes financially distressed. The requirements of such avoidance include the perfection (i) being made after the suspension of payments or the filing of an insolvency petition and (ii) not being made within 15 days of the creation of the security interest.

Obtaining a guarantee or receiving a payment may become subject to the risk of avoidance under certain circumstances.

8. Project Finance

8.1 Introduction to Project Finance

Following the nuclear power crisis caused by the Great East Japan earthquake in 2011, the electricity industry has changed drastically. Renewable energy has drawn increasing attention as an alternative energy source. The Japanese government has accelerated this movement by introducing the feed-in tariff in 2012. Although the focus is shifting from photovoltaic to other power sources (such as wind, geothermal and biomass), renewables projects remain one of the highlights of the Japanese project finance market. On the other hand, the suspension of operation of nuclear reactors has made the country more dependent on fossil fuels. Thermal power projects are another recent highlight in this field, although the Ministry of Environment has concerns about carbon emission control.

A substantial portion of existing Japanese social infrastructure was constructed during the 1960s and 1970s. To meet the need to renovate and replace these facilities in the coming decades, the Japanese government is facilitating the use of PPP/PFI structures, another trend that market participants are focusing on.

8.2 Overview of Public-private Partnership Transactions

Recently, the most notable area of Japanese PPP transactions is airport concession. Concession rights have been granted for Sendai airport, Kansai airport and Osaka airport. Takamatsu airport, Fukuoka airport and Shizuoka airport are next on the list.

The PFI Act and the Airport Concession Act are the most relevant pieces of legislation to airport concession. Under these Acts, a public authority that administers public facilities confers the right to operate the airport facilities on a concessionaire, who is then allowed to charge users fees for using the airport facilities. The ownership of the airport facilities and land are retained by the government.

Since concession is new in the market, the negotiation and documentation is less standardised. Private parties, together with government authorities, are working to establish new market practice.

Airports are not the only type of facility that can be privatised by the concession method. Tollways and water and sewage systems are hopeful areas, some of which have already been privatised by way of concession.

8.3 Government Approvals, Taxes, Fees or Other Charges

In general, there are no material regulatory approvals or taxes unique to project finance transactions, save that specific projects may trigger such requirements (see **8.7 The Acquisition and Export of Natural Resources**).

In general, the transaction documents are governed by Japanese law and do not need to be registered or filed with a governmental body.

8.4 The Responsible Government Body

The Agency for Natural Resources and Energy is the principal government body which is responsible for the Japanese policy regarding natural resources and energy. In addition to the Basic Act on Energy Policy, several laws and regulations are implemented for each sector of the energy industry.

8.5 The Main Issues When Structuring Deals

The most common legal forms of a project company are stock corporations (*kabushiki kaisha*) and limited liability companies (*godo kaisha*). A stock corporation is the most general form of corporation and a limited liability company is a more summary form.

If the lender provides the project company with a commitment line and would like to rely on the exemption under the Commitment Line Act (see **4.3 Usury Laws**), the project company cannot be a limited liability company.

There are no material restrictions on foreign investment in a stock corporation or a limited liability company, save for notification under the Foreign Exchange and Foreign Trade Act.

8.6 Typical Financing Sources and Structures for Project Financings

With respect to the domestic projects, bank facilities are the major sources of the financing.

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8.7 The Acquisition and Export of Natural Resources

Mining natural resources such as oil, natural gas and minerals may be subject to a licence requirement under the Mining Act and other relevant regulations. The export of natural resources is not subject to any special restrictions under the Foreign Exchange and Foreign Trade Act.

Under the Foreign Exchange and Foreign Trade Act, a prior notification to the government should be filed with respect to any foreign investment in a Japanese company that is engaged in the operation of certain types of infrastructure, such as electricity generation. There is a 30-day waiting period from the date of the receipt of the notification, which may be shortened to two weeks in the absence of any substantial issues. During this period, the government will review the proposed investment, taking into consideration national security, public order and public safety.

8.8 Environmental, Health and Safety Laws

The basic environmental policy of Japan is set out under the Basic Environment Act. In addition, there are various environmental, health and safety laws, such as the Air Pollution Control Act, the Water Pollution Control Act, the Soil Contamination Countermeasures Act, the Noise Regulation Act, the Vibration Regulation Act, the Industrial Water Act, the Offensive Odour Control Act, the Waste Management and Public Cleaning Act, and the Environment Impact Assessment Act.

Most of these Acts are administered by the Ministry of Health, Labour and Welfare, and the Ministry of Land, Infrastructure, Transport and Tourism.

9. Islamic Finance

9.1 Overview of the Development of Islamic Finance

The Banking Act and related regulatory guidelines, and other financial regulations have been amended in recent years to reflect Japanese financial institutions' interests in Islamic finance. Major banks have welcomed the reforms and are extending the provision of Islamic finance services internationally.

9.2 Regulatory and Tax Framework for the Provision of Islamic Finance

Although the regulatory and tax framework no longer seems to present any material obstacles to the provision of Islamic finance, experts point to a lack of Shari'a advisers in Japan as a long-term challenge. This stems from the relatively low Muslim population in Japan.

Japanese insurance companies have provided takaful insurance in Islamic countries via their local subsidiaries.

9.3 Main Shari'a-compliant Products

One of the major products that Japanese legislation has prepared is a bond-type beneficial interest. This instrument is issued utilising a trust structure.

9.4 Claims of Sukuk Holders in Insolvency or Restructuring Proceedings

The legal characteristic of a bond-type beneficial interest is trust beneficial interest, rather than bond itself. However, a bond-type beneficial interest is treated as if it were a bond for the Japanese tax purposes.

9.5 Recent Notable Cases

As the issuance of Shari' a-compliant products under Japanese law has not been very popular, there is no recent notable case law in this regard.