

Recent Changes in Japanese Legislation against Global Warming and their Impact on Real Estate Transactions

I. Overview

Tackling global warming is generally regarded as an important international issue, and Japan as a member of the international community has accepted an obligation to reduce emissions of greenhouse gases ("GHGs"). Japan has announced a target to reduce the emissions of GHGs by 25% by 2020 (compared to the 1990 level) under certain conditions in order to fulfil this obligation.

Achieving such a significant reduction will require promoting the reduction of domestic emissions in Japan. As a part of these domestic measures the following laws and regulations were recently enacted or amended:

- the Act on Rational Use of Energy (the "**Energy Saving Act**") and regulations made under the Energy Saving Act;
- the Tokyo Metropolitan Environment Ordinance for Preservation of Health and Safety of Citizens (the "**Tokyo Environment Preservation Ordinance**") and regulations made under the Tokyo Environment Preservation Ordinance; and,
- the Act on Promotion of Global Warming Countermeasures (the "**Global Warming Countermeasures Act**") and regulations made under the Global Warming Countermeasures Act (the Energy Saving Act, the Tokyo Environment Preservation Ordinance, and the Global Warming Countermeasures Act, collectively, the "**Three Laws**").

The Three Laws impose sanctions including fines for breach, which will mean that all participants in significant real estate transactions (whether trust banks, purchasers, asset managers, property managers, lenders or investors) will need to confirm compliance with the Three Laws (see Chart 1 below for details). This will become a due diligence item requiring detailed checks for future plans to invest in significant properties or real estate related M&A deals in Japan (particularly in Tokyo). As a result, even companies that are not subject to the compliance regime themselves will need to understand what is regulated under the Three Laws, who is subject to its obligations, and how to confirm compliance.

The Three Laws cover similar ground, but unfortunately each has its own notification and reporting requirements. The details of these requirements (such as filing parties, planned periods of reduction, documents required to be filed or existence of an emissions trading scheme) are different depending on each of the Three Laws. Accordingly, close attention needs to be paid when compliance with each of the Three Laws is examined (See Chart 1 below).

Key Issues

Three pieces of energy saving and environment related legislation, namely the Energy Saving Act, the Global Warming Countermeasures Act and the Tokyo Environment Assurance Ordinance were amended between 2008 and 2010. Business operators and building owners covered under each piece of legislation need to comply with the new regulatory arrangement.

Under the Energy Saving Act and the Global Warming Countermeasures Act, filing obligations are now imposed on each business operator. Accordingly, a wider scope of parties are subject to filing obligations.

The Tokyo Metropolitan Government has, for the first time in Japan, imposed mandatory obligations to reduce emissions of CO₂ on owners of large buildings, premises, and factories. A scheme of emissions trading and a new system of emission credits have also been introduced in Tokyo.

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For example, the Tokyo Metropolitan Government sets certain standards and imposes mandatory obligations to reduce GHGs emissions in certain office buildings, commercial facilities, hospitals, and factories, etc., using energy of 1500 kilolitres or more of crude oil per year (consecutively for 3 years) (collectively "**Specified Office Buildings**" (*tokutei ondanka taisaku jigyocho*)), whereas the National Government only imposes voluntary targets to reduce emissions on business operators based on the current regime. Although each of the Tokyo Metropolitan Government and the National Government has its own emissions trading scheme, trading between the two markets is not possible based on the current regime. To further complicate matters, the Tokyo scheme of emissions trading does not accept either Kyoto Credits such as Certified Emission Reduction or domestic credits such as the Japanese Verified Emission Reduction or Offset Credits. Therefore, when acquiring emissions credits, close attention needs to be paid in ascertaining which credits are accepted in which emissions trading markets.

II. Energy Saving Act

The summary of regulations under the amended Energy Saving Act effective as of April 2010 are as follows.

- (1) The target for the energy management obligations is now the business operator (i.e., the owner of several business sites), as opposed to the owner of each business site (such as each office building or factory) (which was the case under the previous regime).
- (2) Any business operator whose energy use is equivalent to 1,500 kilolitres or more of crude oil per year is designated as a *tokutei jigyocho* or "Specified Business Operator(s)". Each Specified Business Operator must appoint an energy management control officer (*energy kanri tohkatsu sha*) (such as a company director or officer in charge of overall control of energy management of the business operator) and an energy management planning promoter (*energy kanri kikaku suishin sha*) (such as someone who has completed an energy management training course to be in charge of daily operation and to assist the energy management control officer).
- (3) The Specified Business Operators are required to submit periodic reports on energy use.

III. Global Warming Countermeasures Act

Under the 2008 amendment of the Global Warming Countermeasures Act, which took effect from April 2009, the obligations of a business operator emitting over a certain level of GHGs (*tokutei jigyocho haishutsusha* or "**Specified Emitter**") regarding the calculation, reporting and disclosure schemes on GHGs emissions implemented by the earlier legislation have increased in quality and quantity.

- (1) Reporting obligations have been expanded and amended from a report per business site to a report per business operator. Where a business operator owns more than 2 business sites each of whose energy use is equivalent to 1,500 kilolitres or more of crude oil per year, before the amendment of the Global Warming Countermeasures Act, the business operator had to submit reports for each of the business sites (i.e., two or more separate reports). In contrast, such business operator is now only required to submit one combined report showing (i) the figures for each business site and (ii) the total emission across all applicable sites. Under the amended Energy Saving Act, the reporting obligation is also now borne by each business operator.
- (2) The calculation method of CO₂ when using electricity has been amended to calculate GHGs emissions in respect of use of electricity based on the emission calculation formula agreed with the Ministry of Environment per business operator. It will be an incentive for a business operator, not limited to a Specified Emitter, to choose an electric power company which offers electricity with lower emission calculation formula rather than making such choice based solely on price of electricity.

- (3) The reporting of not only actual emissions of GHGs but emissions reduction reflecting adjusted emissions after taking into account any credits under the Kyoto Mechanism, voluntary domestic emissions trading schemes, trial emissions trading schemes and other domestic schemes have become mandatory.

Specified Emitters can report on the CO₂ emissions of energy origin under the Global Warming Countermeasures Act by using the periodical report under the Energy Saving Act to the competent authorities. Specified Business Operators are required to submit their reports to the competent authorities which are in charge of supervising Specified Business Operator's business as well as the Economic and Industrial Bureau (*keizai sangyo kyoku*) of the Ministry of Economy, Trade and Industry as well.

IV. Tokyo Environment Preservation Ordinance

The Tokyo Environment Preservation Ordinance only applies to Tokyo. However, it has attracted the same amount of attention as the Energy Saving Act and the Global Warming Countermeasures Act, mainly it imposes an obligation to reduce total emissions of CO₂ (by 6-8%) in Specified Office Buildings.

- (1) Obligation to Reduce Total Emission and Cap & Trade

The party who will bear the Total Reduction Obligation to the Tokyo Metropolitan Government ("**Obligator**") is the owner of the Specified Office Buildings. For example, in a real estate securitisation scheme, if the target assets are hard assets, the special purpose company (SPC) which is the owner of the hard assets will become the first Obligator, and when using a trust, the trustee (in most cases a trust bank) will become the first Obligator. In addition, where other affiliated entities act in roles such as asset manager or property manager and that entity has agreed to take on the obligation, not only must notice to the Tokyo Metropolitan Government be given, but also an allocation of obligations between such parties is required. Further, when the asset manager is the Obligator, note that the asset manager is required to file a notice under the FIEL for engaging in side business.

If the Obligator is not able to fulfil its reduction target within the First Planning Period ("*daiichi keikaku kikan*" 1 April, 2010-31 March, 2015) on its own, it will need to buy the necessary emissions credits using the Tokyo Emissions Trading Scheme to fulfil its obligations. In reality, as one cannot rely on large amounts of excess reductions to be available in the market, the challenge will be to find emissions credits suppliers. The fulfilment term regarding the total reduction obligations is after the completion of the planning period, which is at the year-end after the one-year calculation period; for example, this would be the fiscal year-end of 2015 (31 March 2016) with respect to the First Planning Period (See Chart 2 below). During the planning period and calculation period, sale and purchase of real estate, etc. is conducted, and if there is a change in the Obligator, the Obligator at the time of the obligated term of fulfilment shall bear the obligation to reduce total emissions for the period of 5 years. The reduction obligation is not on a pro-rata basis. In other words, only the owners of Specified Office Buildings (i.e. Obligators) as of 31 March 2016 (the "**Cut-off Date**") for the First Planning Period shall bear the obligation to reduce total emissions for a period of 5 years (i.e., former owners who disposed of Specified Office Buildings before the Cut-off Date will not bear the obligations). However, even though the former owners of the Specified Office Buildings will not be subject to the obligation to reduce total emissions, the price of the Specified Office Buildings at the time of its sale may well be affected depending on the need for future emissions reductions.

If there is a breach of the obligation to reduce emissions, the Obligator at the time of the obligated term of fulfilment is likely to receive from the Tokyo Metropolitan Government a cease and desist order. The cease and desist order states the emissions reduction at 1.3 times the reduction shortage. By the order fulfilment term, if such Specified Office Buildings fail to fulfil the order and thus breaches the order, not only does the Obligators have to disclose the fact of breach to the acting governor, etc., but there is also the possibility of a fine being imposed up to JPY500,000 and public disclosure.

In the future, confirmation of compliance with emission reduction obligations will be required at the due diligence stage of real estate investment and M&A. Helpfully, the account holder's name, standard emission, obligated reduction (%), and information on emission performance will be disclosed to the public on the Tokyo Metropolitan Government Home Page. On the other hand, information such as the amount of emission credits held, etc., transfer records, fulfilment of obligated amounts, will not be disclosed; rather, the account holder has to apply for a certificate. It will be necessary for the other party of the transaction to confirm compliance by confirming the information both on the Tokyo Metropolitan Government Home Page and the certificate.

(2) Submission Obligation for the Plan and Report

Furthermore, the Tokyo Metropolitan Government requires offices using energy of 1,500 kilolitre or more of crude oil per year to create and submit a Global Warming Countermeasures Plan and Report on Calculation of Specified GHGs emissions.

In addition, business tenants which either (i) occupy 5,000 square meters or more of an office building using energy of 1,500 kilolitres or more of crude oil per year or (ii) use electricity of 6 million kilowatts or more per a year in such office building (*tokutei tenant jigyosha* or "**Specified Tenants**") are required, through the Obligator, to submit to the Tokyo Metropolitan Government a Specified Tenant, etc., Global Warming Countermeasures Plan and must promote unique energy saving countermeasures (the Office Building owner is obliged to submit to the Tokyo Metropolitan Government plans from these Specified Tenants together with the Office Building's overall plan).

V. Final Remarks

As each business operator now has a reporting obligation under the amendments to the Energy Saving Act and Global Warming Countermeasures Act, , and as the subject of the reporting obligation has been expanded from the previous regulations, it is now necessary for each business operator to reconfirm compliance with these regulations.

For example, business operators who are involved in multiple developments such as small scale offices, commercial facilities and factories may now be caught under the new regime even if they were not under the old one.

Affiliated parties to real estate transactions holding properties with the obligation to reduce total emissions under the Tokyo Environment Preservation Ordinance might need to deal with allocation of obligations among relevant parties or consider giving notice of side business under the FIEL. Their compliance status should be followed closely, because if necessary countermeasures are not taken promptly, this might lead to unexpected expenditure and draw suspicion that the law is breached at the time the terms of the obligation are fulfilled.

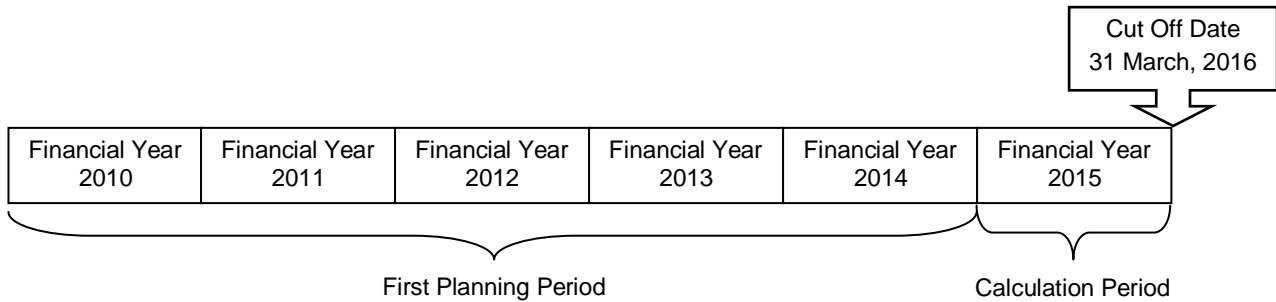
In conclusion, now is the time for anyone who might be affected by the new regime to ensure that they understand the full impact of the new regime in order to reduce future legal risks and costs.

Chart 1: Comparison of the Three Laws

	Energy Saving Act	Global Warming Countermeasures Act	Tokyo Environment Preservation Ordinance
Obligated Party	Mandatory Reporting Business operators using energy of 1,500 kilolitres or more of crude oil per year.	Mandatory Reporting Business operators using energy of 1,500 kilolitres or more of crude oil per year.	Mandatory Total Reduction: Office Building using energy of 1,500 kilolitres or more of crude oil per year (consecutively for 3 years). Global Warming Countermeasures Planning Scheme: Office Building using energy of 1,500 kilolitres or more of crude oil per year (even for a single year). Global Warming Countermeasures Reporting Scheme: Office buildings using energy of 30-1,500 kilolitres of crude oil per year across all office buildings (voluntary). Business Operator owns/ occupies office buildings using energy of 3,000 kilolitres or more of crude oil per year across all office buildings in Tokyo using energy of 30-1,500 kilolitres (compulsory). Global Warming Countermeasures Reporting Scheme for Specified Tenants, etc.: Total floor area of more than 5,000square meters for the occupied section or a tenant of more than 6,000,000 khw/year (compulsory).
Regulated Object	Energy Usage Amount	CO ₂ ,CH ₄ ,N ₂ O,PFC,HFC,SF ₆	CO ₂ ,CH ₄ ,N ₂ O,PFC,HFC,SF ₆
Subject Body	Business Operators	Business Operators	Office Building (building, factory, store, etc.)
Planned Period of Reduction	(No regulation)	First Commitment Period(2008 ~2012) Second Commitment Period (2013~2018)(scheduled)	First Planning Period (2010~2014) Second Planning Period (2015~2019) Planning Period once every 5 years moving forward

	Energy Saving Act	Global Warming Countermeasures Act	Tokyo Environment Preservation Ordinance
Documents to be submitted	Notice of Usage Situation Regular Report Notice of Appointment and Dismissal Mid- and Long Term Plan (more than 3,000 kl/year)	Reporting of carbon dioxide equivalent greenhouse gas emissions	Confirmation on Emissions Situation Global Warming Countermeasures Plan Application on Standard Emissions Report on Global Warming Countermeasures
Promotion Regime	Energy Management Control Officer Energy Management Planning Promoter Energy Manager Energy Management Member	No indication	Global Warming Countermeasures Control Officer Global Warming Countermeasures General Technical Advisor Promotion Manager Promotion Member
Emissions Trading Market	No regulation	Trial Emissions Trading Scheme Voluntary Domestic Emissions Trading Scheme	Tokyo Emissions Trading System
Usable Credit	No regulation	Domestic Credit	Excess Reduction, Tokyo Medium and Small Credit, Renewable Energy Credit, Outside Tokyo Credit
Related Laws and Ordinances	Order, Ordinance, etc.	Order, Ordinance, Reporting Order, Ministerial Ordinance on Calculation, Ministerial Ordinance on Collection Method, etc.	Ordinance, etc.

Chart 2: the Fulfilment Term of the First Planning Period



Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

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