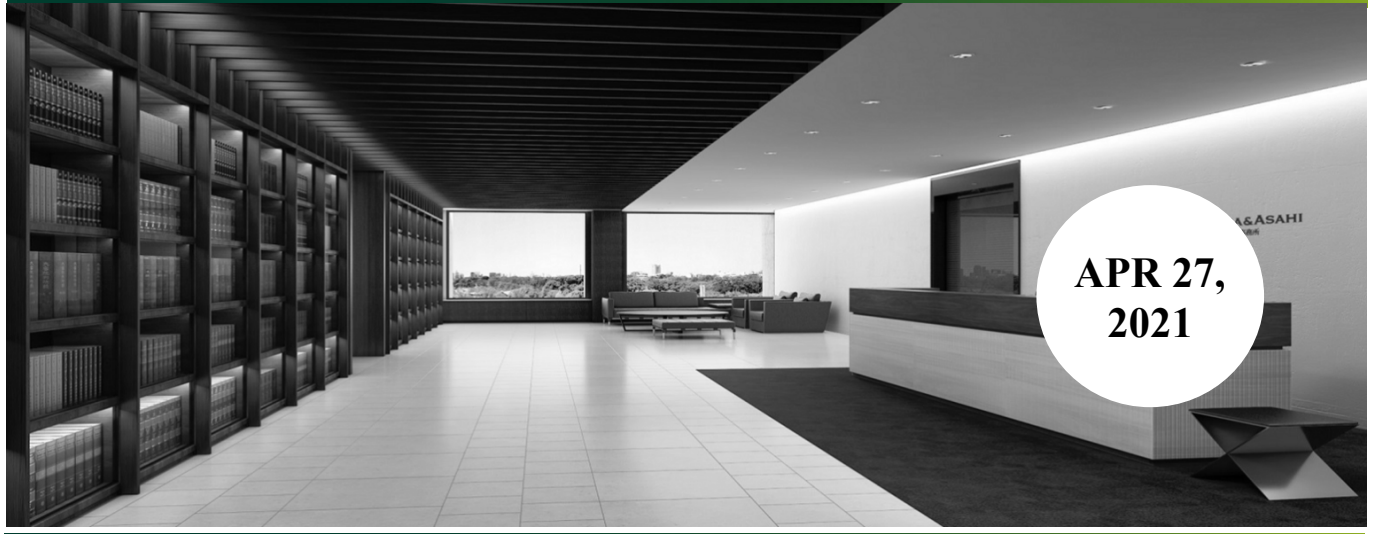


Finance Law Newsletter



Legal Considerations in Financing Japanese Aquaculture (Part 1)

Yasunari Sugiyama

In December of 2020, Japan's Fisheries Act saw enactment of its first major revision in over 70 years (the “**Revised Fisheries Act**”), including a relaxation of restrictions concerning who can participate in commercial fishing and aquaculture activities. Correspondingly, there has been a flood of aquaculture project reports,¹ with the majority focused on the land-based production of fish. The timing is apt, as the catch volume and number of “natural” fishery employees continue to decline. The Revised Fisheries Act seeks to fill this catch deficit with cultivated fish, through promotion of efficient operation and improvement of aquaculture techniques, as well as the vital step of making it easier for companies to secure the necessary number of workers. However, in order to sustainably scale-up and advance aquaculture facilities (nets, premises, buildings, water tanks, filtration systems, pipes, etc.), it is also essential to provide ongoing support through financing methods that meet the special needs of aquaculture businesses.²

Nishimura & Asahi attorneys specialized in agri-food business conduct research on the unique industrial structure, business risks, and regulations in this field. This article (together with Part 2) outlines some of the legal issues they have encountered associated with providing financing for aquaculture businesses.³

¹ The National Oceanic and Atmospheric Association defines ‘aquaculture’ as the “cultivation of aquatic organisms in controlled aquatic environments for any commercial, recreational or public purpose” and includes therein any “breeding, rearing, and harvesting of fish, shellfish, algae, and other organisms”.

² For example, the number of fishery employees decreased from approximately 700 thousand in 1961 to approximately 325 thousand in 1993, and again to approximately 153 thousand in 2017. The catch volume also decreased sharply after 1990, peaking at 12,820,000 tons in 1984 and shrinking to 4,420,000 tons in 2018 (Fisheries Agency, Annual Report on the Developments in Japan's Fisheries in FY2019).

³ The literature, judicial precedents, and other materials pertaining to this field are both scarce and in flux. Given that these newsletters are based on such sources (especially from the relevant ministries and agencies), it is possible that they may not sufficiently reflect the actual state of aquaculture business practices and regulations beyond their publication date. **As such, it is always best to consultate an N&A specialist for the latest information.**

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I Outline of the Revised Fishery Act

1. Application of the Fishery Act

Unsurprisingly, the presence of water, which is the habitat of fish, is essential for fisheries. The Fisheries Act divides “water” into three categories: (i) sea surface (i.e. marine, including lakes and marshes connected to the sea), (ii) inland (waters other than those qualifying as “sea surface”) and (iii) waters not intended to be accessible to the public (excluding those waters connected to, and used as an integral part of, waters provided for public use). The Fisheries Act is only applicable to (i) sea surface and (ii) inland waters and, within those environments, sea-based cultivation (e.g. placing rafts separated by nets on the sea) and inland water cultivation (e.g. aquaculture of freshwater fish and other freshwater organisms). Alternatively, when breeding tanks are used for land-based aquaculture (e.g. in what are called the “water flowing” or “closed-circulation” methods) such activities fall under (iii) and are not subject to the Fisheries Act. Accordingly, the applicable laws and regulations for structuring debt or equity investments differ significantly between marine & inland water cultivation and land-based aquaculture.

2. Major contents of the revised act

The Revised Fishery Act integrates the Act on the Preservation and Control of Living Marine Resources (TAC Law) into the Fishery Act and incorporates (i) the establishment of a new resource management system (creating resource management targets based on scientific evidence and the intended maintenance and restoration of resources), (ii) a review of the fishery licensing system with a view toward improving productivity (enhancing competitiveness and realizing fishery industry stabilization via increasing the attractiveness of participation therein to young people), (iii) a review of the sea surface use system that contributes to the development of aquaculture and coastal fisheries (with a view toward promoting the appropriate and effective use of such areas), and (iv) measures and regulations concerning the revitalization of fishing villages and the fulfillment of multiple functions thereof.⁴

3. Impact on the aquaculture business

The most relevant revisions to aquaculture business finance are related to 2(iii) above, and there is a growing possibility that, thanks to the Revised Fisheries Act, new companies will enter the aquaculture industry and existing fishery managers will establish new aquaculture farms. Specifically, the revised law imposes on fishery right holders the duties to appropriately and effectively utilize their fishing grounds and to report on such ground’s status/condition to be eligible for license renewal. When deciding upon the granting of fishery rights, the statutory priority order under the old act was abolished and now: (i) if the existing fishery right holder is making appropriate and effective use of the fishing ground, they will be (re)granted the fishery right;⁵ (ii) if there is no existing holder, or if

⁴ For more information, see “Outline of the Bill for Partial Revision of Fishery Act, etc.” (Japanese language) by the Fisheries Agency. https://www.jfa.maff.go.jp/j/suisin/s_kouiki/nihonkai/attach/pdf/index-98.pdf

Class 1 demarcated fishery aquaculture: operated with stones, roof tiles, bamboo, and trees, laid in a certain region;

Class 2 demarcated fishery aquaculture: operated in a certain region surrounded by earth, stones, bamboo, and trees (bank type or net-partitioned);

Class 3 demarcated fishery aquaculture: operated in a certain region, other than those prescribed in the preceding two items.

Aquaculture is typically Class 1, but if fish are cultivated in a wide area of the sea surrounded by earth, stones, bamboo and trees, it falls under Class 2.

⁵ As a general rule, the term of a fishery right is 10 years for demarcated fishery rights on pearl aquaculture, etc., and 5 years for other demarcated fishery rights, so it is widely believed that demarcated fishery rights on ordinary aquaculture fish will be reviewed every 5 years.

the existing holder is not making appropriate and effective use of the fishing ground, the applicant for such right whose prospectus indicates the greatest likelihood of contributing to the development of the local fishery industry will be granted the fishery right. Accordingly, project proposals requiring financing can have such needs met in the case of both (i) and (ii) above, with the latter directing such funding toward the construction and other initial costs of industry entrance. However, if an existing fishery right holder can show proof of continuous use of their fishing grounds, they will be given priority⁶ over both existing fishery right holders in the process of altering their traditional business model and new or expanding aquaculture businesses where such projects were previously deemed difficult (for example, areas with high tidal waves or tidal currents).⁷

II Type of aquaculture, requirements and regulations

1. Main features

As mentioned above, the aquaculture industry is broadly divided into sea surface (marine) & inland water cultivation and land-based aquaculture. The following table summarizes the characteristics of each category and the applicable regulations.

Aquaculture method	Sea Surface and Inland Water Cultivation	Land-based aquaculture
Target area	Sea Surface: Coastal and other marine areas Inland Water Cultivation: Lakes, rivers, ponds, etc.	Land
Required fishery right	Demarcated fishery right	Not required
Regulations Applicable	Fishery Act Sustainable Aquaculture Production Assurance Act ⁸ Inland Fisheries Promotion Act Feed Safety Act ⁹	Sustainable Aquaculture Production Assurance Act Feed Safety Act Inland Fisheries Promotion Act ¹⁰ Waste Disposal Act Soil Contamination Law (in the case of a flowing method type) Water Quality Pollution Control Act
Force Majeure (Natural Disasters and Climate Change) Risks	Vulnerable	Indoor types are less vulnerable
Other Merits	Ease of access to processing plants, fishing ports and markets Low initial investment costs Farm can be moved over the sea Positive assessment in SDGs/ESG in terms of protection and preservation of natural resources	Filtration devices can eliminate the effects of parasites such as anisakis and contaminants such as micro-plastics and heavy metals. ¹¹ Positive assessment in SDGs/ESG in terms of protection and preservation of natural resources and the low environmental load

⁶ As, in the case of appropriately utilized fishing grounds, it is assumed that they will be making further efforts to develop such business.

⁷ Aquaculture businesses are classified as demarcated fisheries under the Fisheries Act. A demarcated fishery is divided into classes 1 to 3 as shown below, but can be difficult to distinguish based on the wording of the Act.

⁸ The Domestic Animal Infectious Diseases Control Law applies only to mammals, birds, and honeybees of the species specified by the Law and the Enforcement Order, and the Sustainable Aquaculture Production Assurance Act regulates fish-based infectious diseases.

⁹ In addition to mammals, birds and honey, the Feed Safety Act also covers fish and crustaceans such as yellowtail, red tail, silver salmon, greater amberjack, flatfish, tiger puffer, yellow jack, mackerel, yellowtail amberjack, spotted sea bass, sea bass, cobia, blue-fin, prawn, carp, eel, rainbow trout, sweet-fish, landlocked salmon, red spotted trout, and char.

¹⁰ Under the current law, the land aquaculture to which the licensing requirement under the Inland Fisheries Promotion Act is applied is limited to eel aquaculture businesses under the Enforcement Order of said law.

¹¹ Since eggs of anisakis are ingested by plankton such as krill and, after plankton is predated by fish, anisakis becomes larvae in the body of such fish, the risk of Anisakis can be reduced or eliminated by controlling feed in closed circulation aquaculture facilities. On the other hand, when seawater is injected directly into the facilities, the condition is the same as that of sea-based cultivation.

2. Material Regulation 1 - Fisheries Act

(1) Fishing Ground Plan (Articles 62 and thereafter of the Fisheries Act)

Prefectural governors are required to formulate Sea-area Fishing Ground Plans and Inland Waters Fishing Ground Plans every five years. Matters related to fishery rights in sea areas and inland waters (including location and demarcation of fishing grounds, type of fishery, period of fishing right, distinction of individual fishery right or organization fishery right, etc.) are described therein. Therefore, it is possible to find basic information regarding existing fishery rights and, accordingly, identify the potential for new entrants in the sea surface and inland waters aquaculture industry that would be the target of financing. To this end, when preparing a draft Fishing Ground Plan, prefectural governors must acknowledge not only the views of potential new entrants (fishery managers), but also those of persons operating, or intending to operate, fisheries in the area concerned and other interested persons. Depending on the timing, there may be room for the investors and financier of an aquaculture project to express their views on the Fishing Ground Plan, in such comment process through current or proposed fishery managers.¹²

(2) Demarcated Fishery Right (Articles 68 to 96 of the Fisheries Act)

In order to conduct aquaculture related business in a specific area (i.e., a demarcated fishery), it is necessary to obtain a demarcated fishery right; this entails certain obligations and requirements:

- application for a demarcated fishery right (or re-application upon lapse of a license noting such right, which necessitates ensuring that the applicant or license holder does not fall under certain disqualification criteria);¹³
- proof of the appropriate and effective use of fishing grounds (in the case of an existing fishery right holder) or persuasive evidence indicating the greatest potential contribution to the development of the local fishery industry (such as increasing outputs and securing employment opportunities, in the case of new entrants);¹⁴ and
- prefectural governor's approval, and corresponding absence of restrictions and meeting of requirements necessary, for the disposal of fishery rights (such as division, alteration, loan and creation of security interests, compliance with the conditions of the fishery right, report of resource management status, and compliance with the guidance and recommendations of the prefectural governor).¹⁵

These may be covered by the covenants and default provisions at the time of financing transactions.

¹² In addition, information is available from the Registration of Licensed Fisheries (the Fishery Right register, the Piscary Register, the Fishing Ground Chart, and the Fishery Trust Register) under the Fishery Register Order.

¹³ According to the Fisheries Act, a fishery right is deemed to be a property right and the land-related provisions apply *mutatis mutandis* (the Fisheries Act Article 77, para.1). However, the voluntary assignment, transfer, lease, etc., of a fishery right by the fishery right holder is legally restricted.

¹⁴ Appropriate and effective use of the sea means that the fishing ground is utilized to sustainably increase fishery productivity through resource management and aquaculture production suitable to the environment of such fishing ground (the Guideline on Marine Use System of the Fisheries Agency).

¹⁵ (i) If fishing grounds are not properly utilized and hinder another fishery manager's production or deteriorate the marine environment, or (ii) some portion goes unutilized without reasonable grounds, the prefectural governor will issue guidance and recommendations. If the fishing grounds are not improved, the fishery right will be cancelled or suspended. Also, a fishery right may be cancelled by the prefectural governor if the right holder is absent for one year from the date of grant of fishery license or for two consecutive years thereafter, which can be an opportunity for new entrants.

3. Material Regulation 2 - the Sustainable Aquaculture Production Assurance Act

(1) Basic Policy for assuring sustainable aquaculture production (Article 3 of the Sustainable Aquaculture Production Assurance Act)

The Basic Policy for ensuring sustainable aquaculture production concerns prevention of the spread of specified diseases via: (i) general improvement goals; (ii) organization of facilities; (iii) area-wide system improvements; and (iv) other related matters. Basically, this Act targets fishery right holders and Fisheries Cooperative Associations engaged in sea surface cultivation or inland water cultivation (hereinafter collectively referred to as a “Demarcated Fishery Right Holder”), but it is understood that this basic policy for prevention of the spread of specified diseases should serve as a guideline for the conduct of land-based aquaculture business operators. Therefore, when financing aquaculture business operators, it is helpful to establish covenants with respect to compliance with the Sustainable Aquaculture Production Assurance Act and the Basic Policies, and the establishment of systems required thereunder.

(2) Aquaculture Area Improvement Plan and Recommendations (Article 4 and thereafter of the Sustainable Aquaculture Production Assurance Act)

A Demarcated Fishery Right Holder (which, as noted, excludes land-based aquaculture operators) may formulate a Fishing Area Improvement Plan (for subject aquatic plants and animals in the aquaculture area) that outlines measures, timing, facilities, and system targets, amongst others, for meeting aquaculture area improvement goals, and obtain approval of such plan from the prefectural governor. Approval of an Aquaculture Area Improvement Plan is not a legal obligation, but it serves as a basis for the compliance of the aquaculture business and aquaculture area with the Sustainable Aquaculture Production Assurance Act and the Basic Policy. Therefore, it is possible for financing of an aquaculture project to require provision of an approved Fishing Area Improvement Plan and proof/testament of compliance with prefectural governor recommendations, etc., in the conditions precedent or covenant clauses.

(3) Duties relating to Specified Diseases (Article 8 of the Sustainable Aquaculture Production Assurance Act and below)

Irrespective of aquaculture methods, aquaculture operators are obliged to notify prefectural governors when they discover or suspect the outbreak of a specified disease (the applicable infectious diseases are specified by the Enforcement Order for each type of aquatic animal and plant). The prefectural governor may order the notifying aquaculture operator to (i) undergo an inspection, (ii) burn, bury or restrict the transfer of farm-raised aquatic animals and plants that have actually or possibly contracted a specified disease, and (iii) sterilize facilities such as fishing nets, fish reserves, etc., to which pathogens are, or may be, attached. In addition, from the perspective of preventing the spread of specified diseases, etc., prefectural governors are authorized to order the inspection, injection, immersion bathing or other drug administration of the aquatic animals and plants and to conduct on-site inspections at aquaculture facilities, etc., and to collect associated reports. Violations of such regulations not only cause damage to fish stocks,¹⁶ but also significantly affect the reputation of the aquaculture industry, as well as specific areas and operators. Therefore, it is expected that covenant clauses will require discussion of adequate and prompt responses to diseases, including preventive measures.¹⁷

¹⁶ Salmonidae fish, carp, crucian carp, red tail, shrimp, abalone, oysters, sea squirts, etc., are specified.

¹⁷ In the event a loss is incurred due to the transfer restriction, burning, sterilization, or other disposition based on an order issued by a prefectural governor, compensation in the amount that would normally be incurred for such processes will be allowed.

4. Material Regulations 3 - Feed Safety Act

(1) Use of Feed

The Minister of Agriculture, Forestry and Fisheries has established standards for the manufacture, use, preservation, and labeling and standards for ingredients in respect of feed and feed additives based on the Feed Safety Act (Act for Ensuring the Safety and Improved Quality of Feeds). However, the Feed Safety Act primarily regulates the production and sales of feed or feed additives that do not conform to its standards, and does not directly regulate the use of feed or feed additives by aquaculture business operators.¹⁸

However, when the use of harmful substance-containing feeds, etc., are prohibited or when prefectural personnel collect reports or conduct on-site inspections, etc., the users of feed or feed additives are also subject. Therefore, aquaculture business operators are required to cooperate with and respond to these dispositions.¹⁹

(2) Manufacture and Sale of Feed

In aquaculture business areas, the farming methods, including feed mixture, are progressing rapidly, and it is anticipated that aquaculture operators will make efforts to mix or improve the feeds. For example, when an aquaculture operator purchases feeds from a manufacture or imports feeds from abroad and then mixes locally obtained materials with such feeds for use at its aquaculture facility, such action will be deemed ‘manufacture of feed’ and will be subject to regulation under this Act. Further, if such operator successfully improves or develops the feeds and sells them to other persons, such operator shall be subject to enhanced regulations under the same.²⁰

It should be noted that the regulations under the Feed Safety Act will change and case by case responses will be required when an operator uses feeds purchased or imported from a third party manufacturer to make a mixture or improve the feeds or feed additives or sells such mixed or improved feeds to other persons.

(Following to Part 2)



[Yasunari Sugiyama](#)

Partner, Nishimura & Asahi
y.sugiyama@nishimura.com

Yasunari Sugiyama is a partner in the firm’s asset finance group and his major and unique areas include the financing of movables, agri-food business debt/equity investment, domestic and cross-border real estate transactions and the support for overseas expansion by financial institutions. In particular, he aims to provide legal services for the introduction of smart agriculture, investments and M&As regarding domestic and overseas agri-corporations, and diversification of financing sources, while organizing the various laws and regulations applicable to each phase of farming, plant factory and aquaculture businesses.

¹⁸ It is also assumed that feed or feed additives produced overseas will be imported for use in the course of aquaculture business. However, the target of the Feed Safety Act is the import “for sale”, so import for use by aquaculture business operators themselves is not included in the prohibited category.

¹⁹ Collection of required reports on the use of feed (the Feed Safety Act Article 55, para.3), access to aquaculture facilities, inspection of the use of feed, raw materials and feed, questioning of persons concerned, and removal of feed and raw materials (the Feed Safety Act Article 56, para.3)

²⁰ In the case of manufacture of feeds for sale, manufacture not meeting the prescribed standards and specifications is prohibited and the manufacturer is subject to a notification requirement (Article 50 of the Feed Safety Act). In the case of manufacture of feeds not for sale, the notification requirement is not applicable, but the manufacturer will be subject to other regulations under the Feed Safety Act (including the prohibition by the Minister of Agriculture, Forestry and Fisheries in respect of the manufacture of harmful substance-containing feeds).