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Enhanced governmental oversight of foreign investments in rare earths

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Introduction

In 2010 the Japanese manufacturing sector suffered a significant disruption following an unofficial ban by China on all exports of rare earths to Japan.⁽¹⁾ Rare earths are of great importance to the Japanese manufacturing sector because they are essential components for manufacturing numerous electronic and high-technology devices, including:

- mobile phones;
- computer hard drives;
- medical imaging equipment;
- electric motors;
- missile and aircraft guidance and control systems;
- optics;
- radar;
- guided weapons; and
- telecommunications.

This incident highlighted the importance of secure supply chains as a matter of national economic security and, more specifically, the critical role of rare earths in the manufacturing sector.

In recognition of the importance of rare earths for Japan's economic security, on 18 August 2021 the government announced that the Foreign Exchange and Foreign Trade Law (the Foreign Exchange Law) will be amended to add rare earths and certain other minerals that are viewed as essential to the Japanese manufacturing sector (the "rare earth minerals") as a protected industry under the Foreign Exchange Law (the amendment). This means that any foreign investment in industries or businesses related to the exploration, development or supply of rare earth minerals will be subject to enhanced governmental oversight. The amendment is scheduled to become effective as of 4 November 2021.

The government explained the rationale for the amendment as follows:

From the perspective of economic security of Japan, it is an important issue for our country to secure stable supply of important mineral resources like rare-earth with a view to achieving the goal to overcome of the weakness of supply chain. Due to the movements for climate change and other global issues, it is expected that the demands for those minerals will increase all over the world. It is needed for our country to urgently address the issues of procurement of stable supply of those important mineral resources. If the important mineral resources located in the subsea area within the territorial waters of Japan become available, it will be a promising breakthrough for our country to escape from the current status where we almost fully rely on the supply of such minerals from overseas. Thus, maintenance and procurement of our country's capability to research the mineral resources are needed from the viewpoint of national economic security.⁽²⁾

Foreign Exchange Law

The Foreign Exchange Law provides for governmental oversight of foreign direct investment in Japan in businesses or industries deemed by the government to be critical to Japan's national security or public interest. The Foreign Exchange Law subjects foreign investors⁽³⁾ acquisition of shares in companies that are engaged in a "designated business" to enhanced governmental oversight, potentially including prior approvals and the submission of post-acquisition reports and filings. Assessing whether a share acquisition requires prior governmental approval depends on a complex analysis of:

- the number of shares being acquired;
- the type of foreign investor involved;
- whether the foreign investor agrees to curb its shareholder rights;
- the foreign investor's history of regulatory compliance; and
- the business activities of the target Japanese company, notably, whether the target Japanese company is a designated business.

The Foreign Exchange Law defines a "designated business" as an entity engaged in any "designated business sector", including a "core sector". A "designated business sector" means any of the general business activities listed below, and a "core sector" is a subset of any of the identified designated business sectors. Following the amendment, the scope of designated business sectors and core sectors will be as follows:⁽⁴⁾



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Designated business sectors	
	Core sector
Weapons	All business activities.
Aircraft (ie, the manufacturing of aircraft, rockets and the parts thereof)	All business activities.
Space	All business activities.
Nuclear facilities	All business activities.
Dual-use technologies (ie, manufacturers, engineering service providers and software developers that deal with products and technologies that are subject to Japanese export control regulation)	All business activities.
Cybersecurity	<ul style="list-style-type: none"> cybersecurity-related services (eg, network security monitoring, forensic service, remote access control systems, security software against unauthorised access, malware and phishing); Japanese language input software; service providers of programmes designed for critical infrastructure; and service providers of programmes specifically designed to handle personal information and sensitive personal information of at least 1 million people.
Electricity	<ul style="list-style-type: none"> general electricity transmission and distribution utilities; electricity transmission utilities; and electricity generation utility companies that own a power plant with a maximum generation capacity of at least 50,000 kilowatts.
Gas	<ul style="list-style-type: none"> general gas or specified gas pipeline service providers; gas manufacturers; and liquified petroleum gas companies that own a storage facility or core cylinder filling station.
Telecommunications	Telecommunication carriers that provide service across multiple local municipalities.
Water supply	<ul style="list-style-type: none"> water supply companies that supply more than 50,000 people; and bulk water supply companies with a capacity to supply over 25,000m³ of water per day.
Railways	Railway service companies operating public facilities or infrastructures that are stipulated under the Armed Attack Situations Response Act.
Oil	<ul style="list-style-type: none"> oil refineries; oil storage facilities; crude petroleum facilities; and natural gas production facilities.
Heat supply	None.
Broadcasting	None.
Public transport	None.
Biological chemicals	None.
Security services	None.
Agricultural, forestry and fishery services	None.
Leather manufacture	None.
Air transport (ie, air transport providers such as Japan Airlines)	None.
Maritime transport	None.
Rare earth mineral mining businesses (including exploration for and supply of natural resources)	All business activities.

Designated business sectors	
	Core sector
The manufacture, repair and development of machinery and programmes related to the exploration for and supply of rare earth minerals	All business activities.
The manufacture, repair and development of components related to the exploration and extraction of rare earth minerals	All business activities.

The term "rare earth minerals" is defined under the amendment as any of the following minerals:

- antimony;
- barium;
- beryllium;
- bismuth;
- boron;
- caesium;
- chromium;
- cobalt;
- fluorine;
- gallium;
- germanium;
- graphite;
- hafnium;
- indium;
- lithium;
- magnesium;
- molybdenum;
- nickel;
- niobium;
- platinum;
- rare earths;
- rhenium;
- rubidium;
- selenium;
- silicon;
- strontium;
- tantalum;
- tellurium;
- thallium;
- titanium;
- tungsten;
- vanadium; and
- zirconium.

The impact of this proposed amendment is that any contemplated investment by a foreign investor into a Japanese entity that is engaged, whether in whole or partially, in mining, exploration or development related to rare earth minerals will be subject to enhanced review under the Foreign Exchange Law. Following the amendment coming into effect, it will be even more critical for foreign investors looking to invest in a Japanese entity that is engaged in the exploration and supply of natural resources to carefully conduct due diligence on the target entity, to determine whether its business activities fall within any of the newly added designated business sectors or core sectors therein. If they do, foreign investors will need to consider what actions must be taken to comply with the Foreign Exchange Law. Failure to conduct such analysis could result, among other things, in the transaction being set aside or rejected by the government.

Comment

The government's proposed amendments to the Foreign Exchange Law are deliberately broad and expansive, reflecting its intention to take actions to ensure a stable supply of the necessary resources required by its manufacturing sector. It will be interesting to see if further amendments to the Foreign Exchange Law will be made by the government to implement similar oversight and protections for other resources or sectors that are viewed as critical to Japan's national economic security.

For further information on this topic please contact [Peter G Armstrong](#) or [Yoshiaki Otsuki](#) at [Nishimura & Asahi](#) by telephone (+81 3 6250

Endnotes

(1) Rare earths are a set of elements that are generally interpreted as including:

- cerium;
- dysprosium;
- erbium;
- europium;
- gadolinium;
- holmium;
- lanthanum;
- lutetium;
- neodymium;
- praseodymium;
- promethium;
- samarium;
- scandium;
- terbium;
- thulium;
- ytterbium; and
- yttrium.

(2) The government's statement is available [here](#) (in Japanese).

(3) A "foreign investor" is an individual or entity that is a non-resident of Japan, or a Japanese-organised company for which at least 50% of the voting rights are directly or indirectly owned or controlled by a non-resident of Japan.

(4) This list is for reference purposes only, it is not intended to be a comprehensive list. The final three categories are the newly added designated business sectors and core sectors.