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BRIEFING

SUMMARY

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Recent developments in soil contamination countermeasures law

The Soil Contamination Countermeasures Law was amended last year. A recent government report has highlighted the considerable impact of the new amendments. This briefing summarises the key changes under the recent amendments that, among other things, expanded owners' obligations to conduct contamination investigations and clarified remediation responsibilities. This briefing also assesses the impact of the amendments on real estate transactions, including due diligence.

In April this year, the environment ministry issued a report on the impact of recent amendments to the Japanese Soil Contamination Countermeasures Law (the Law). The ministry reported that an alarming number of properties have been designated as contaminated following recent amendments to the Law effective from 1 April last year (the 2010 Amendments).[1]

Although the details of the 2010 Amendments may have been forgotten by many, their recently reported impact cannot be ignored. More generally, soil contamination is an increasingly important issue in Japan. Residents are expressing concerns about local contamination issues and businesses are realising they are potentially liable for contamination on acquired land, regardless of their fault or knowledge of the contamination at the time of acquisition. Understanding the Law – including the 2010 Amendments – is thus important for any person involved in the real estate sector.

This briefing answers some of the common questions that arise regarding the Law and the 2010 Amendments. If you have any other questions, please do not hesitate to contact your usual Freshfields lawyer or one of the team listed below.

[1] The report states that 131 properties have been designated as contaminated as a result of the 2010 Amendments. The number 131 is not a total figure: it does not include other properties designated as contaminated under the existing parts of the Law that continue in force. The total number of contaminated properties will therefore exceed 131 and will be a significant increase on the 2009 figure of 94 cases, and will almost certainly be twice the 2008 figure of 71 cases. See the environment ministry's *Designation of Action Land and Reporting Land pursuant to the Soil Contamination Countermeasures Law* (dated 1 April 2011) *and Results of the survey on the enforcement status of the Soil Contamination Countermeasures Law and Soil Contamination Investigations and Countermeasures in FY 2008/FY 2009* (dated March 2010/2011).

Who is responsible for soil contamination under the Law?

Primarily, an owner is responsible for soil contamination on his land, even if he did not know the soil was contaminated when he acquired the land. In this way, the Law's allocation of primary responsibility to the owner is different from US and some European countries' systems. In particular, an owner must conduct soil contamination investigations (as described below) even where a third party (and not the owner) was the cause of the contamination.

Is there a possibility that a mortgagee will be held responsible under the Law? Also, how about a case where a secured lender owns land because the security was created by way of transfer (*Joto Tanpo*)?

A mortgagee will not be responsible for soil contamination under the Law. Similarly, a secured lender under a *Joto Tanpo* arrangement will not be responsible. With *Joto Tanpo*, the borrower who had previously been owner (but whose title was transferred to the secured lender) will remain responsible for soil contamination.

When must an owner conduct soil contamination investigations under the Law?

Soil contamination investigations are not necessary merely because soil contamination exists on land. Rather, an owner is only obliged to conduct soil contamination investigations in the following circumstances:[2]

[2] Additional obligations may be imposed by local government ordinances.

(a) where a facility dealing with any of 25 specified harmful substances is closed down or ceases to be used as such;
(b) where a governor determines that soil contamination is likely to exist after receiving notice of a plan to transform land of 3,000 square meters or more (Large Scale Land) (see below for details); or
(c) where a governor determines that due to soil contamination human health is likely to be harmed.

An investigation order under (c) above will only be issued if soil contamination is likely to exist and such soil contamination is likely to harm human health. For example, if soil contamination exists on a factory site, but people other than employees cannot access the site and underground water cannot be consumed, an order will not be issued. Notably, only five investigations in total have been made under (c) above since the Law was enacted in 2003.

What are the obligations of a Large Scale Land owner?

An owner must conduct soil contamination investigations where a governor determines that soil contamination is likely to exist after receiving notice of a plan to transform Large Scale Land. This is a new obligation introduced by the 2010 Amendments. In the past reporting year alone, 87 parcels of Large Scale Land were designated as contaminated because of this new investigation obligation.

In detail, if an owner plans to transform Large Scale Land by, for example, mining and excavating soil, rocks or other objects, developing residential areas or cultivating the land, the owner must, subject to exceptions, report the plan to a governor 30 days before starting the transformation. The exceptions to this general rule are limited. For example, if an owner plans to develop the site by filling earth on the land, the investigation requirement does not apply as it is unlikely that soil contamination (if any exists) will spread to other areas.

After receiving notice of a planned transformation of Large Scale Land, the governor must consider whether soil contamination is likely to exist. If so, he can order the owner to conduct a soil contamination investigation of the Large Scale Land. The governor's order must specify the area of the site, the type of harmful substances to be investigated, and the reason why the governor considers it likely to be contaminated, as well as the deadline for reporting the investigation results.

What's involved in a soil contamination investigation? And what happens if an owner fails to conduct a mandatory investigation?

A soil contamination investigation must be conducted by an investigation firm designated by the environment minister. The owner is responsible for payment of the firm's costs. The investigation firm must conduct its investigation in accordance with certain prescribed processes.

In limited circumstances, an investigation may not be required. In particular, if it is obvious soil contamination exists and an owner accepts that his land is contaminated, then the owner may omit all or part of the investigation process, reducing the owner's investigation costs.

If an owner does not follow an investigation order issued by the governor, the owner may face up to one year's imprisonment or a fine of up to ¥1m. If a governor considers that it seriously harms the public interest not to investigate potentially contaminated land, the governor may conduct an investigation and request the owner to pay the investigation costs.

What happens if soil contamination is discovered as a result of an investigation?

A governor shall designate any contaminated site as either of the following:

- if the soil contamination is likely to harm human health, then the land will be designated as land requiring an action to remedy the contamination (*yo sochi kuiki*, Action Land); or
- if the soil contamination is unlikely to harm human health, then the land will be designated as land in respect of which any proposed future transformation (eg a development of the land) must be reported to a governor in advance (*keishitsu henkoji todokede kuiki*, Reporting Land).

The governor's designation will be publicised and made available for inspection at a relevant prefecture.

Land will be designated as Action Land only where soil contamination is likely to harm human health. Therefore, if measures are taken to prevent public entry onto a site and to prevent drinking of groundwater, then

the contamination is unlikely to harm human health and should be designated as Reporting Land (or, if it has been designated as Action Land, it should be re-designated as Reporting Land).

In contrast, before the 2010 Amendments, remedial measures were only required following a specific ‘order’. Such an order had only been issued once since the Law’s introduction in 2003. The 2010 Amendments require remediation of Action Land in all cases and as such will be more frequently used. Indeed, in the past reporting year alone, 35 plots of land were designated as ‘Action Land’, an alarming increase compared to one case in seven years under the old Law.

Contaminated land is designated as Action Land by a governor who instructs the owner to take remedial measures. However, a third party other than an owner caused the soil contamination (a Contaminator). Is the owner still responsible to take remedial measures?
Yes, unless the governor instructs the Contaminator to take remedial measures instead.

An instruction to remedy contamination will be issued to a Contaminator if all of the following circumstances apply:

- it is clear that the soil contamination was caused by the Contaminator (who is a person other than the owner);
- the Contaminator can satisfy the costs of remedial measures; and
- the owner does not object to the Contaminator taking such measures.

Thus, if the Contaminator cannot be identified or is unable to pay the costs of remedial measures, then an instruction to remedy contamination will be issued to the owner.

Based on our informal discussions with the Tokyo metropolitan government, there have been no cases in which an instruction has been issued to a Contaminator. This is because there have been relatively few cases in which contamination remedial measures were required in the past. A process for determining to whom an instruction should be issued is therefore yet to be established.

Can a Contaminator be compelled to compensate for costs of remedial measures incurred by an owner?
Yes, in some circumstances. Under a special compensation system, an owner may seek compensation from a Contaminator in respect of the owner’s remediation costs where the contamination was caused by the Contaminator. For example, if, after an owner took remedial measures, a Contaminator’s financial condition has improved and he is able to pay for the costs of such measures, an owner may require the Contaminator to pay such costs. However, the owner may only seek compensation equal to the remediation costs only and not other costs, such as the costs of investigating the suspected contamination.

The Contaminator’s obligation to compensate the owner for the costs of remedial measures is strict and applies if the Contaminator caused the contamination. Thus, it is irrelevant whether the Contaminator was at fault or was negligent in causing contamination of the land. For example, even where the Contaminator’s use of a substance on the land was not legally prohibited at the time it caused contamination, the Contaminator will still be liable provided such substance is one of the 25 specified harmful substances under the current Law.

If an owner purchased contaminated land from a Contaminator, what claims could he bring against the Contaminator?
The owner may claim under a relevant sale agreement and/or the Civil Code of Japan.

If the sale agreement between the owner and Contaminator included an environmental warranty, then the owner may be able to claim for misrepresentation and/or breach of warranty. In addition, the owner may be able to claim for ‘defect liability’ under the Civil Code. However, in most real estate transactions among sophisticated investors, an environmental warranty will not be offered in the sale agreement and, further, a seller will typically seek to contract out of defect liability under the Civil Code.

Notwithstanding the market practice of contracting out of Civil Code defect liability, it should be noted that the Contaminator/seller cannot contract out where:

(a) the Contaminator/seller knew, and did not disclose to the owner/purchaser, that soil contamination existed;

(b) the Contaminator/seller holds a *Takken Gyo* licence (ie a professional real estate agent); or
(c) the owner/purchaser is an individual protected by the Japanese Consumer Protection Law.

Thus, with (a), if a Contaminator/seller knew that soil contamination existed (which, according to court precedents, may include the case where a Contaminator/seller is grossly negligent), the Contaminator/seller cannot rely on sale agreement provisions that limit their Civil Code defect liability and, accordingly, the owner may be able to bring a claim.

What if the Contaminator did not sell the land to the owner? Can the owner seek compensation for any damage he suffers?

Yes. In the absence of a contractual relationship between the Contaminator and owner, it may still be possible for the owner to sue the Contaminator on the basis of tort liability (ie that the Contaminator negligently contaminated the land and such contamination caused the owner damage). However, if the Contaminator used a substance on the land that was not regulated by law at the time of use, but which later caused contamination and damage to the owner, it is unlikely that the Contaminator will be held liable. This is because the Contaminator's conduct was not illegal and is thus unlikely to have been negligent.

How can an owner obtain subsidies for the costs of taking contamination remedial measures?

An owner may be granted a subsidy of up to three-quarters of necessary remediation costs if all of the following conditions are met:
(a) the Contaminator is unknown or does not exist (eg due to bankruptcy/winding-up, etc);
(b) the contaminated land has been or will be designated as 'Action Land'; and
(c) the owner meets financial tests (ie for a corporation, both share capital and net asset value are less than ¥300m respectively).

If a Contaminator is known, but is financially incapable of paying remedial costs (excluding where the Contaminator is already bankrupt), condition (a) will *not* be satisfied and a subsidy will not be granted to the owner. This is because the owner can instead request the Contaminator to pay remedial costs under the Law as explained above.

Based on our informal discussions with the Japan Environment Association (JEA), which is responsible for granting subsidies, there have been only two applications since this system started in 2003 and in both cases a subsidy was granted. This is evidently because there have been relatively few cases where contamination remedial measures were required and Contaminators were not identified.

We also discussed the issue with the Tokyo metropolitan government and Yokohama City, who explained that no application for a subsidy has been made to them since this system started, while Osaka prefecture has received only one application for which a subsidy was granted (ie one of the two granted cases described above).

However, as the 2010 Amendments expanded parties' obligations to conduct contamination investigations and take remedial measures, it is expected that there will be an increase in the number of future subsidy applications. Indeed, if an owner conducts a voluntary investigation and a Contaminator is unknown (satisfying condition (a) described above), then the owner should consider reporting the result to a governor so that the owner can use the subsidy (if conditions (b) and (c) are also met).

In real estate transactions among professional investors, due diligence of properties typically includes soil contamination examinations. If soil contamination is found, is an owner obliged to report it to a governor?

No, reporting of soil contamination found as a result of voluntary investigations is not required.

However, the 2010 Amendments allow an owner to report the result of a voluntary investigation and request a governor to designate land as 'Action Land' or 'Reporting Land.'

One of the merits of permitting an owner to voluntarily report the investigation results is certainty of outcome. If the land is designated as Reporting Land, the owner may take comfort that remediation is not required. If land is designated as Action Land and a governor instructs that certain remedial measures shall be taken, the owner can be certain that compliance with such measures will satisfy the requirements under the Law. This is important because the trend in Japan for remediation has been to remove contaminated soil completely,

which is costly. In most cases where this approach has been taken, other less costly measures such as capping, filling or containment of contaminated soil would have been enough. How successful this new system will be in changing a widespread trend of removing contaminated soils is yet to be seen.

Another merit of the new voluntarily reporting system is that it may enable an owner to obtain a subsidy for remediation costs.

In the past reporting year alone, 44 properties were designated as contaminated as a result of this new system.

Do local governmental ordinances impose additional and/or stricter obligations than the Law?
Yes, in many cases. For this reason, obligations under local government ordinances, as well under the Law and 2010 Amendments, should be considered carefully by all participants in the real estate sector.

For example, in comparison with the Law, Osaka prefecture's ordinances require a soil contamination investigation to be conducted regarding (i) the closing down of a 'smaller size' facility dealing with 'dioxin' in addition to the 25 specified harmful substances prescribed by the Law; and (ii) a transformation of land (ie development, mining, etc) on which such facility is located.

Another example is the ordinances of the Koto ward, Tokyo, which require a person who constructs a condominium building on a site of 1,000m^2 or more to endeavour to conduct a soil contamination investigation and take appropriate remediation. According to the Koto ward, although the obligation only appears to require efforts to be taken, in practice it requires reporting an investigation's results.

Is it possible that the Law will be amended so that additional substances are regulated? If so, what should owners and other real estate participants do?
Based on recent discussions with the environment ministry, there are no planned amendments to the Law to include additional substances in the list of hazardous substances requiring contamination investigations or remedial measures. However, future amendments to the Law cannot be ruled out and it is possible that owners' liabilities under the Law may be expanded.

As such, we understand some international companies are taking a cautious approach by conducting voluntary investigations for substances that, although not regulated in Japan, are regulated overseas or by internal company policy. We think owners should consider this cautious approach. In particular, if an owner is already planning to undertake a voluntary investigation for prescribed substances, the cost of expanding the investigation to cover additional substances may be small when weighed against the potential liability and risks faced by the owner in the future.

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