

# Public-Private Partnerships

*Contributing editors*

Ivan E Mattei and Armando Rivera Jacobo



2019

GETTING THE  
DEAL THROUGH

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Ivan E Mattei and Armando Rivera Jacobo  
Debevoise & Plimpton LLP

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# Preface

## Public-Private Partnerships 2019

Fifth edition

**Getting the Deal Through** is delighted to publish the fifth edition of *Public-Private Partnerships*, which is available in print, as an e-book and online at [www.gettingthedealthrough.com](http://www.gettingthedealthrough.com).

**Getting the Deal Through** provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Greece.

**Getting the Deal Through** titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at [www.gettingthedealthrough.com](http://www.gettingthedealthrough.com).

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

**Getting the Deal Through** gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Ivan E Mattei and Armando Rivera Jacobo of Debevoise & Plimpton LLP, for their continued assistance with this volume.

GETTING THE  
DEAL THROUGH 

London  
September 2018

# Japan

Miho Niunoya, Yuko Nihonmatsu, Shintaro Hamasu and Masayuki Matsuura

Atsumi & Sakai

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## General PPP framework

### 1 How has the concept of public-private partnership (PPP) developed in your jurisdiction? What types of transactions are permitted and commonly used in your jurisdiction?

Japan has what is called the Act on Promotion of Private Finance Initiative (the PFI Act). However, there is some ambiguity regarding PPP, for which there is no statutory definition. PPP is sometimes used to describe projects that are not in the form of PFI. In practice, design-build-operate and design-build-maintain type projects are commonly used in addition to PFI. There are also projects such as ones in which a government party leases land to a private party and the private party carries out business on the land, or projects in which the government party enters into a comprehensive contract with a private party for the operation of public infrastructure. These all come under the umbrella of public-private partnerships.

### 2 What categories of public infrastructure are subject to PPP transactions in your jurisdiction?

Public infrastructure categories subject to PPP transactions include:

- transportation (airports, roads and harbours);
- renewable energy generation systems;
- water supply;
- waste water treatment systems;
- telecoms;
- social infrastructure (schools, hospitals, government buildings, prisons, tourism facilities, research facilities, sports facilities, libraries and meetings, incentive travel, conferences, exhibitions and events (MICE));
- parks;
- parking; and
- satellites, etc.

### 3 Is there a legislative framework for PPPs in your jurisdiction, or are PPPs undertaken pursuant to general government powers as one-off transactions?

PFI projects (including concessions) are carried out in accordance with the PFI Act. Other PPPs are carried out without any specific legislative framework. However, as the PFI Act and related guidelines set out in detail the procurement and evaluation processes for determining a winning bidder, PPP projects other than PFI tend to adopt procurement or evaluation processes similar to those for PFI projects.

### 4 Is there a centralised PPP authority or may each agency carry out its own programme?

Each agency carries out its PPP projects separately. However, there is a department called the PFI Promotion Office within the Cabinet Office. This department does not tender individual projects but formulates bills or guidelines, supports authorities, provides information and generally works to ensure that there is an environment that encourages PPPs, in discussion with each of the relevant government agencies for the promotion of PFI projects (including concessions).

### 5 Are PPPs procured only at the national level or may state, municipal or other subdivision government bodies enter into PPPs?

In addition to the national government, prefecture-level governments (including waterworks bureaus and prefectural police) and city-level governments (including municipal schools and waste disposal organisations), incorporated administrative agencies, incorporated educational institutions, quasi-government bodies, etc. enter into PPPs.

### 6 How is the private party in a PPP remunerated in your jurisdiction?

The most common form of PPP projects in Japan is the 'availability payments' form, in which payment of compensation to the private party is conditional upon whether the private party has provided services, and it is irrelevant whether the facilities are used by users (known as 'service purchase type'). Stand-alone type projects, in which the private company only earns income from user fees, have not been popular in Japan until recently. However, the 'concessions' system was recently introduced upon amendment of the PFI Act in 2011 and has been quickly increasing. Other forms of stand-alone type PPPs have also been on the rise recently.

### 7 May revenue risk or usage risk be shared between the private party and the government? How is risk shared?

As described in question 6, in conventional PPP projects, the government assumes the revenue risk or usage risk for projects where the government party pays compensation for services to the private party (known as 'service purchase type'). However, in recent years, there have been more projects where the private party assumes these risks instead of the government under a stand-alone type project. There are also projects in which the private party earns project income together with subsidies from the government party (known as a 'joint venture type'), in which case, these risks are shared by both the government and the private parties.

### 8 In situations where the private party is compensated in whole or in part through availability or other periodic payments from the government, are the payment obligations of the government subject to the relevant legislative body approving budgetary funding in the future?

The budget of national and local governments of Japan is determined by resolution every fiscal year. However, in most PPP projects, the government needs to pay costs that span two or more fiscal years. In such case, the government usually determines the budget for future payments by resolution of the legislative body at the stage of bidding for the PPP projects. However, even in such a case, the government cannot automatically make payments from such budget in the future but needs to pass a legislative body resolution approving the expenditure for the year in which it is actually made.

### 9 Is there any cap on the rate of return that may be earned by the private party in the PPP transaction?

There is no specific cap for PPP transactions in Japan. However, in general, it is perceived negatively for private parties to earn too much

from PPP projects. Therefore, the agreement between the private party and the government often includes a provision that requires the private party to share a portion of revenue from the PPP project over a certain amount.

**10 Is the transfer of direct or indirect ownership interests in the project company or other participants restricted?**

There are no legislative restrictions. However, in practice, agreements between the government and private parties for most PPP projects require consent of the government for transfer of ownership interests. Many projects also are conditional on the representative company of the consortium continuing to maintain at least 50 per cent ownership until the end of the project.

**Procurement process**

**11 What procedures normally apply to a PPP procurement? What evaluation criteria are used to award a PPP transaction?**

Many projects use the type of bidding process that evaluates both price and other elements of a proposal or an open-type proposal process. In these schemes, a predetermined point system is used to evaluate bidders based on the price they present for bidding (price points) and the proposals they submit for bidding (evaluation points), with the highest-scoring bidder selected as the winning bidder. Proposals are commonly evaluated by a review committee that includes external experts.

**12 May the government consider proposals to deviate from the scope or technical characteristics of the work included in the procurement documentation during the procurement process, without altering such terms with respect to other proponents? How are such deviations assessed?**

Projects with a large technical component often require a technical proposal. Where required, the procurement documentation will state that a technical proposal is required and how such proposals will be evaluated. Without such provisions, proposals cannot deviate from the scope specified in the procurement documentation. It is possible to use the public question and answer process to ask the government about proposals that deviate from the scope specified in the procurement documentation (that is, to what extent deviation from the procurement documentation is allowable). Further, in some projects, the procurement process affords bidders the opportunity for discussion in a competitive dialogue.

**13 May government parties consider unsolicited proposals for PPP transactions? How are these evaluated?**

As a result of the amendments to the PFI Act in 2011, unsolicited proposals from private companies are now accepted for PFI projects. If a private party submits an unsolicited proposal in accordance with the procedures set out in the PFI Act, the government party is obliged to consider the proposal and to notify the private party of the outcome. The method of evaluation is left to the discretion of each government party but guidelines prepared by the Cabinet Office stipulate that evaluation should take into consideration the necessity and feasibility of the proposed transaction, whether it is appropriate to implement it using PFI and the financial impact of the proposed transaction.

**14 Does the government party provide a stipend for unsuccessful short-listed proponents or otherwise bear a portion of their costs?**

There are no statutory provisions regarding such stipends, and they are not generally paid in practice. However, there have been PFI projects in which a stipend was paid to unsuccessful shortlisted proponents (including, for example, a PFI project for improvement of municipal primary and secondary school facilities in the city of Yokkaichi, in which bidders shortlisted for the first screening that were unsuccessful in the second screening were awarded a ¥2 million proposal stipend).

**15 Does the government party require that proposals include financing commitments for the PPP transaction? If it does not, are there any mechanisms during the procurement process to ensure that the applicable PPP transaction, once awarded, is financeable?**

Generally, the government party requires bidders to explain the source of funds and bidder financial stability for the project as part of their proposals in the procurement process. Bidders will commonly submit a project finance term sheet or a 'commitment letter' from their bank as an attachment to the proposal submitted to the government party.

**16 May the government ask its counsel to provide a legal opinion on the enforceability of the PPP agreement? May it provide representations as to the enforceability of the PPP agreement?**

Normally, the government does not ask its counsel to provide a legal opinion on the general enforceability of the PPP agreement, but it does ask for a legal opinion on individual points at issue when implementing projects. There are cases where the government is asked to provide representations on the enforceability of the PPP agreement, but that depends on each case. The government often makes representations on the enforceability of the PPP agreement in complicated, large-scale projects such as hospitals, etc.

**17 Are there restrictions on participation in PPP projects by foreign entities? May foreign entities exercise control over the project company?**

The WTO Agreement on Government Procurement applies to projects ordered by the national government or ordinance-designated cities; foreign entities cannot be restricted from participating in PPP projects.

In any other projects, while there are usually no such explicit controls on foreign entity participation, participation is often restricted to bidders with experience of handling similar projects of a similar size in Japan or (especially in the case of local government) in the relevant region, which effectively prevents foreign entities from participating in such projects.

**Design and construction in greenfield PPP projects**

**18 Does local law mandate that any particular form of contract govern design and construction activities? Does it mandate the choice of governing law?**

Neither national nor local law mandates any particular form of contract for design and construction activities, although the PFI Promotion Office provides standard terms.

Parties to contracts in Japan are free to choose the governing law of their agreement.

However, the national government and local governments in Japan designate Japanese law as the governing law in all projects, and project companies accept this as a matter of course.

**19 Does local law impose liability for design defects and, if so, on what terms?**

The legal nature of a design contract is disputed, with some arguing it is a contract for work and some saying it is a quasi-mandate (or otherwise) under Japanese law. The two are different in that if a design contract is considered to be a contract for work, instead of a liability for non-performance of obligations, defect liability will apply with terms covering liability without negligence and an exclusion period, while if it is considered to be a quasi-mandate, then instead of defect liability, if there are defects in the design, liability for non-performance of obligations will apply (without the terms of liability for negligence and period of exclusion). Whether a design contract is a contract for work or a quasi-mandate will depend on the specific agreements among the parties, but there appear to be more cases of design contracts being interpreted as quasi-mandates.

**20 Does local law require the inclusion of specific warranties? Are there implied warranties in cases where the relevant contract is silent? Does local law mandate or regulate the duration of warranties?**

Where necessary, PPP agreements will contain defect liability provisions with regard to the facilities being provided in the project. The PPP

agreement will usually also contain detailed provisions on the terms of the defect liability and the liability period. For national projects, it is required by law to expressly include defect liability provisions in the contract under the Cabinet Order on Budgets, the Settlement of Accounts and Accounting.

If a PPP agreement itself does not contain any provision regarding defect liability, then the rules of the Civil Code and the Housing Quality Assurance Act apply.

Under the Civil Code, the duration of a contractor's defect liability is one year from the delivery of the subject matter, and if the subject matter is a structure on land, the contractor is liable for defects in structure or ground for five years in the case of an ordinary structure or 10 years for any structures made of stone, earth, bricks, concrete and steel and other similar structures. However, it is also provided that the duration of the contractor's defect liability may be extended by contract to 10 years under the Civil Code.

In the case of contracts to construct new homes, a special exception to article 638 exists that extends the duration of defect liability for important parts of the house in terms of structural integrity to 10 years across the board under the Housing Quality Assurance Act.

It is provided in such provision that in general, if the subject matter delivered by the project company contains any defects, the manager, etc, may demand that the project company repair such defects in the subject matter within a certain period of time or claim damages from the project company instead of or in addition to repairs.

In Japan, there are cases where the PPP agreement will contain a provision obliging the project company to procure from the construction company a guarantee stating that it will perform the defect liability and submit this guarantee to the government party.

#### **21 Are liquidated damages for delay in construction enforceable? Are certain penalty clauses unenforceable?**

The parties may freely agree on liquidated damages for delays in the construction period. However, these may be unenforceable if the amount is found to be against the public order and morals.

It is common for the agreed liquidated damages (penalty) amount to be set to equal to the construction costs (or construction costs of the unfinished portion) multiplied by the rate set forth in article 8 of the Act on Prevention of Delay in Payment under Government Contracts, etc (2.8 per cent per annum as of July 2016) prorated by the number of days of the delay: that is from the scheduled delivery date (or the scheduled commencement date of operation) to the date of actual delivery (or the commencement date of operation).

#### **22 What restrictions are imposed by local law on the contractor's ability to limit or disclaim liability for indirect or consequential damages?**

The law in Japan does not restrict a contractor's ability to limit or disclaim liability for indirect or consequential damages.

#### **23 May a contractor suspend performance for non-payment?**

Usually, a contractor may not suspend performance for non-payment. The Civil Code stipulates that delivery of the subject matter and the payment of remuneration shall be performed simultaneously.

In many cases, a PPP agreement will contain a provision stipulating that facilities improvement costs shall be paid after the delivery of the subject matter, and that completion and delivery of the facilities shall be performed first.

#### **24 Does local law restrict 'pay if paid' or 'paid when paid' clauses?**

The prime contractor must in some cases pay its contractors, whether or not it has received payment from the ordering party, and must do so within 60 days of the provision of services in the case of design service under the Act against Delay in Payment of Subcontract Proceeds, Etc to Subcontractors or within 50 days of the proposed delivery of the subject matter in the case of building construction under the Construction Industry Act.

#### **25 Are 'equivalent project relief' clauses enforceable under local law?**

Generally, such clauses are not enforceable under Japanese law.

#### **26 May the government party decide unilaterally to expand the scope of work under the PPP agreement?**

Generally, the PPP agreement will contain a provision stipulating that if the government party needs to change the scope of work, it shall notify the private party giving its reason for the change and discuss the change of scope, but if an agreement is not reached after such discussions, then the government party may change the scope of work by notifying the private party thereof. In this case, the private party's increased costs or damages are usually also borne by the government party, and contract terms such as project schedule are also revisited.

#### **27 Does local law entitle either party to have a PPP agreement 'rebalanced' or set aside if it becomes unduly burdensome owing to unforeseen events? Can this be agreed to by the parties?**

The law in Japan does not entitle either party to have a PPP agreement 'rebalanced' or set aside.

Normally, in the case of an unforeseen event not attributable to either party occurs, it is resolved upon discussion between the parties or by applying a force majeure or change of law clause.

#### **28 Are statutory lien laws applicable to construction work performed in connection with a PPP agreement?**

The method of creating a mortgage over concession rights is provided in the PFI Act.

Other than the above, general laws such as the Civil Code apply to the creation of security interests over facilities or special purpose company shares, etc.

#### **29 Are there any other material provisions related to design and construction work that PPP agreements must address?**

The PFI Act requires that PFI agreements executed by local governments that meet certain criteria require a resolution by local government council in advance. Furthermore, the Act on Prevention of Delay in Payment under Government Contracts, Etc, requires that government contracts (including PFI agreements) contain provisions for the confirmation of completion or timing of inspection of the performance that is the purpose of such contract, the timing of payment of compensation, default interest, penalties and any other charges in the case of delayed performance or non-performance of obligations by either party and the method of resolving any disputes relating to such contract.

In addition to the above, the important laws and regulations that apply to PFI agreements that are quoted in the 'Guideline for Contract' issued by the Cabinet Office include:

- the Local Autonomy Act (Act No. 67 of 1947);
- the Act concerning State Liability for Compensation (Act No. 125 of 1947);
- the Act on Access to Information Held by Administrative Organs (Act No. 256 of 1949);
- the Public Accounts Act (Act No. 35 of 1947);
- the Act for Promoting Proper Tendering and Contracting for Public Works (Act No. 127 of 2000);
- the Act on Guaranty Service Related to Advance Payment of Public Works (Act No. 184 of 1952);
- the National Property Act (Act No. 73 of 1948);
- the Act on Management, etc of Claims Held by State (Act No. 114 of 1956);
- the Building Standards Act (Act No. 201 of 1950);
- the Housing Quality Assurance Act (Act No. 81 of 1999);
- the Civil Code (Act No. 89 of 1896);
- the Companies Act (Act No. 86 of 2005);
- the Construction Industry Act (Act No. 100 of 1949); and
- the Licensed Architect Act (Act No. 202 of 1950).

#### **Operation and maintenance**

#### **30 Are private parties' obligations during the operating period required to be defined in detail or may the PPP agreement set forth performance criteria?**

Private parties' obligations during the operating period are rarely set forth in the PPP agreement in detail. However, these obligations are usually detailed in service level specifications announced as part of the procurement documentation. The PPP agreement will usually

incorporate service level specifications as a part of the PPP agreement, so effectively the private parties are required to comply with the obligations detailed in the service level specifications.

**31 Are liquidated damages payable, or are deductions from availability payments possible, for the private party's failure to operate and maintain the facility as agreed?**

In most cases, the government party is given the right to reduce the compensation payable to the private party or to make a damages claim if the private party fails to perform its performance obligations. However, the particular terms and amounts are usually determined separately for each project. There is often also a provision stipulating that the private party is obliged to pay default interest at the same rate as the default interest rate applicable to the government party, as determined by legislation, in cases where the private party delays performance of a payment obligation.

**32 Are there any legal or customary requirements that facilities be refurbished before they are handed back to the government party at the end of the term?**

There are no such legal or customary requirements. However, it is often set forth in the PPP agreement that the private party must deliver the facilities in a state in which they can be operated for several years and that the private party must cooperate with the government party in order to ensure a smooth transition to operation by the government party after handover.

**Risk allocation**

**33 How is the risk of delays in commercial or financial closing customarily allocated between the parties?**

Risks associated with delays in contract closing are customarily allocated between the public and private parties depending on the cause of the delay except where risk allocation is expressly stated in the procurement documentation. In other words, the government party would normally assume risks associated with delays to contract closing caused by the government party, and vice versa for delays caused by the private party.

The risk of failure to secure the funds necessary for the project is customarily borne by the private party, but if the private party is obliged to make efforts to obtain financing (subsidies etc) for selected projects, then the PPP agreement may also obligate the government party to make efforts to cooperate with the private party in doing so.

**34 How is the risk of delay in obtaining the necessary permits customarily allocated between the parties?**

The risk of delay in obtaining necessary permits for the private party to carry out the project is customarily allocated to the private party, but the PPP agreement generally also stipulates that if requested by the private party, the government party must cooperate with the private party in obtaining permits as necessary, including provision of necessary documents.

**35 How are force majeure and geotechnical, environmental and weather risks customarily allocated between the parties? Is force majeure treated as a general concept relating to acts outside the parties' control or is it defined with reference to specific enumerated events?**

Force majeure and geotechnical, environmental and weather risks are allocated to the government party as a rule, but they are commonly allocated to the private party up to a certain percentage (often 1 per cent of the amount of compensation for the private party). The definition of force majeure is left to agreement among the parties.

**36 How is risk for acts of third parties customarily allocated between parties to a PPP agreement?**

Risk for acts of third parties is normally allocated to either the public or private party depending on whether such third party is under the control of the public or the private party. For risk allocation in the case where a third-party act is considered to be a force majeure event, see question 35.

**37 How are political, legal and macroeconomic risks customarily allocated between the parties? What protection is afforded to the private party against discriminatory change of law or regulation?**

**Allocation of risk of changes to legislation**

For any increase in costs because of changes to legislation, the parties customarily identify legislation that is directly related to the selected projects and generally allocate to the government party any increase in costs caused by changes to such legislation with the private party bearing cost increases because of changes to the other legislation that affect private companies generally.

**Allocation of risk of changes to taxation**

In the case of cost increases because of changes in the consumption tax rate, which is payable separately from the compensation amount, this is customarily borne by the government party. There may also be cases where the government party bears cost increases because of taxation changes applicable to ownership of properties or because of the introduction of new taxes. Cost increases because of changes in taxation applicable to the private party's profits, such as changes in the corporation tax rate are customarily borne by the private party.

**Allocation of inflation and interest rate risk**

The PPP agreement will often provide a benchmark price level or interest rate level for the parties, and stipulate that the parties may instigate a review if the change exceeds a certain level.

It is customary for the private party to raise funds at a fixed interest rate under an interest rate swap agreement and at present, the interest rate swap market mostly consists of transactions with terms of 15 years or less. For this reason, in the case of projects with longer loan terms, it is customary to incorporate a mechanism for adjusting the compensation amount to reflect future changes in interest rates (such as by revising compensation after the passage of 10 years based on the fixed interest rate for the remaining term, or revising compensation every five years for the following five years).

**38 What events entitle the private party to extensions of time to perform its obligations?**

As a rule, the private party is not entitled to propose extensions to the project period.

However, if it is necessary to extend the construction period because of force majeure or changes to legislation, the private party may make a request to the government party, and after discussion with the government party, a decision may be reached to extend the construction period. If no agreement is reached after such discussion, the government party can usually determine a reasonable construction period unilaterally and the private party must comply. In this way, even in the case of changes to design or delays in the commencement of construction because of force majeure, changes to legislation or a cause attributable to the government party, extension of the construction period is not necessarily guaranteed.

**39 What events entitle the private party to additional compensation?**

As a rule, the private party is entitled to receive compensation for increased costs in the case that the increase is caused by the government party. In the case of an increase in costs because of force majeure or changes to legislation, subject to the risk allocation described in questions 35 and 37, the private party is generally entitled to receive compensation for its increased costs.

**40 How is compensation calculated and paid?**

Compensation is calculated based on the total cost of the project proposed by the private party in the procurement process (construction costs, maintenance, management and operation costs, fundraising costs and profits of the private party). The timing and number of compensation payments vary but are generally handled by dividing the costs into construction costs and maintenance, management and operation costs.

### Update and trends

The Act for a Partial Amendment to the Act on Promotion of Private Finance Initiative was enacted in June 2018, which takes measures for the promotion of provision of public facilities through the utilisation of private finance, management abilities and technical capabilities such as the following:

- enhancing supporting functions of the national government to an administrator of a public facility and private business operators;
- special provisions of the Local Autonomy Act for cases where an operator of a public facility is also a designated administrator; and
- exemption of compensation for early redemption of local government bonds lent to local governments in relation to the water works business.

#### 41 Are there any legal or customary requirements for project agreements to specify a programme of insurance? Which party mandatorily or customarily bears the risk of insurance becoming unavailable on commercially reasonable terms?

Insurance is not legally mandated. However, in practice, the private party is commonly required under the procurement documentation to obtain, at its responsibility and calculation, three types of insurance. These are, namely:

- construction insurance (covering damage to the facilities arising during construction);
- third-party liability insurance (covering bodily injury or property damage incurred by third parties as a result of performance of construction or defects in the use or management of the facilities); and
- performance guarantee insurance (covering penalties payable by the private party to the government party as a result of cancellation of the PPP agreement because of the private party's non-performance of its obligations).

In addition, in the case of build-operate-transfer projects where the facilities are transferred to the government party after completion of the project, it is customary to require the private party to obtain insurance relating to preservation of the facilities, such as fire insurance, etc, and other insurance may be obtained at the discretion of the private party as necessary.

### Default and termination

#### 42 What remedies are available to the government party for breach by the private party?

The PPP agreement will often stipulate that if as a result of monitoring the private party's performance of its obligations, it does not meet the required service level specifications and it is found to not be in compliance with the PPP agreement, then the government party may request improvement from the private party in accordance with processes prescribed in the PPP agreement. If the private party fails to make the requisite improvements, then the government party can usually escalate the matter by suspending payments or reducing the amount of compensation, claiming damages, then instigating a change of service provider, and ultimately terminating the PPP agreement.

#### 43 On what grounds may the PPP agreement be terminated?

A PPP agreement is generally a long-term agreement that does not terminate until the end of a specified contract term. However, even during the contract term, the PPP agreement may be terminated in cases where the relationship of trust between the parties is lost and it becomes difficult to continue the contractual relationship, or where it becomes impossible to carry out the project. Various termination events can be included, but the following events are some common terms:

- agreed events enabling the government party to terminate because of the private party:
  - lengthy delay in the commencement of design or construction;
  - lengthy delay in the completion and delivery of facilities;
  - non-performance of obligations relating to maintenance, management and operation services; and
- the official commencement of insolvency proceedings with respect to the private party;

- agreed events enabling the private party to terminate because of the government party:
  - non-payment of compensation; and
  - a material breach of contract by the government party remaining unremedied and causing difficulty for the private party to carry out the project; and
- all or part of the obligations of the private party under the PPP agreement becoming impossible to be performed because of force majeure or changes to legislation.

#### 44 Is there a possibility of termination for convenience?

It is customary to provide a provision allowing the government party the discretion to terminate the PPP agreement upon prior notice to the private party at least a certain period of time in advance if it becomes no longer necessary to carry out the project or it becomes necessary to repurpose the facilities because of changes in policy of the government party or changes in demand from citizens. However, allowing the government party to retain the right to terminate at its convenience is an unforeseeable risk for the private party, so it is necessary to carefully consider the scope and amount of damages that the private party can claim if the government party decides to exercise this right.

On the other hand, the private party is not customarily given the right to terminate at its convenience.

#### 45 If the PPP agreement is terminated, is compensation available?

The situation regarding compensation varies, but in general, if a PPP agreement is terminated, the party that incurred damage because of the termination may claim damages depending on whether it was the party that caused the termination. In particular, in the case of termination because of the private party, the Public Accounts Act and the Cabinet Order on Budgets, the Settlement of Accounts and Accounting (in the case of the national government) and the Local Autonomy Act (in the case of local government) require that the PPP agreement contains provisions regarding damages for the private party's non-performance of obligations. As a result, it is customary to provide in the PPP agreement that the private party must pay a certain amount in penalties to the government party.

### Financing

#### 46 Does the government provide debt financing or guarantees for PPP projects? On what terms? Which agencies are responsible?

National and local governments are basically prohibited from providing guarantees to private entities; nor do they provide debt finance. However, in PPP projects, government parties sometimes effectively provide financial support to private parties, by leasing public land to the private parties at a low price, for example. This depends on the specifics of the project. The government party will announce the amount of support (if any) in the PPP procurement documentation in advance.

#### 47 Are lenders afforded privity of contract with the government party through direct agreements or similar mechanisms? What rights will lenders typically have under these agreements?

There are cases where the lender directly executes an agreement with the government party. Generally, the following rights of the lender or the government party are agreed upon:

- the government party allows the lender to create a security interest over the private party's assets or shares;
- the lender notifies the government party of the occurrence of an acceleration event under the loan agreement, in which case, the lender and the government party discuss handling;
- where the government party has the right of termination under the PPP agreement, the government party notifies the lender before exercising the same, and if it does, the lender and the government party discuss handling; and
- where the lender steps in using its security interest, the government party may discuss the matter with the private party.

**48 Is there a mechanism under which lenders may exercise step-in rights or take over the PPP project? Are lenders able to obtain a security interest in the PPP agreement itself?**

When a project is financed using project finance, a mechanism usually exists for the lender to step in to the PPP project. The lender executes an agreement giving it an option to assume the private party's contractual position, or to cause a third party designated by it to succeed to the private party's contractual position under the PPP agreement for the purpose of securing its loan receivables. In this way, lenders can sometimes step in to take over a PPP project using the right under the above-mentioned agreement when the loan is accelerated.

**49 Are lenders expressly afforded cure rights beyond those available to the project company or are they permitted to cure only during the same period and under the same conditions as the project company?**

Lenders are not afforded special cure rights. However, when the government party can exercise the right of termination under the PPP agreement as described above, the lender may hold discussions with the government party for a certain period of time under a direct agreement. If handling is agreed during this period, the lender may avoid termination and step in or have a new operator assume the project company's position.

**50 If the private party refinances the PPP project at a lower cost of funds, is there any requirement that the gains from such refinancing be shared with the government? Are there any restrictions on refinancing?**

Gains from refinancing do not need to be shared with government parties. There are no restrictions on refinancing. However, the project company is required to cause the new lender to assume the previous lender's contractual position under a direct agreement with the government agency, or to enter into a new direct agreement with the government agency.

**Governing law and dispute resolution**

**51 What key project agreements must be governed by local law?**

Generally, all agreements that the private party is required to execute with the government party in the procurement documentation (including project agreement, operating service agreement and construction agreement) must be governed by local law. It is generally stipulated in the procurement documentation that these agreements are to be governed by the laws of Japan. On the other hand, agreements between private parties not required to be disclosed in the procurement process may be governed by the laws of other jurisdictions unless otherwise required in the procurement documentation.

**52 Under local law, what immunities does the government party enjoy in PPP transactions? Which of these immunities can be waived by the government?**

Under local law, the government party has no right to enjoy civil immunities in PPP transactions. In the case of wilful misconduct or negligence on the part of any individual public official in the performance of his or her duties, the individual would not be liable to the private party but the government party would.

**53 Is arbitration available to settle disputes under the project agreement between the government and the private party? If not, what regime applies?**

The draft agreements that are disclosed in the procurement documentation as those that the government and the private party are required to execute (including the project agreement, operating service agreement and construction agreement) will generally stipulate that any dispute between the national or local government and the private party shall be submitted to the exclusive jurisdiction of the relevant district court. Arbitration is not generally used. It is often provided in construction agreements that disputes are to be submitted to arbitration by the Central Construction Work Disputes Committee, but this committee is a special agency established solely for construction work disputes under the laws of Japan and is different in nature from general arbitration as understood in international agreements.

**54 Is there a requirement to enter into mediation or other preliminary dispute resolution procedures as a condition to seeking arbitration or other binding resolution?**

In short, there are no such legal requirements. However, the above-mentioned draft agreements disclosed in the procurement process often stipulate that disputes among the parties are to be resolved upon discussion in good faith. This good-faith discussion clause is not a legal requirement before seeking lawsuit or arbitration but doing so is the socially accepted process. Further, construction agreements often stipulate that mediation should be conducted through a mediator selected by the parties or Central Construction Work Disputes Committee prior to arbitration by the above-mentioned Committee.

**55 Is there a special mechanism to deal with technical disputes?**

Disputes in relation to construction agreements are often subject to arbitration awards rendered by the Central Construction Work Disputes Committee. There is no other special mechanism to resolve technical disputes. However, appeals relating to patent rights, utility model rights, layout-design exploitation rights for semiconductor integrated circuits and the right of the author of computer programs are subject to the exclusive jurisdiction of the intellectual property high court.



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