



# Construction

in 36 jurisdictions worldwide

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# Japan

Miho Niunoya, Masayuki Matsuura and Daniel Hounslow

Atsumi & Sakai

## 1 Joint ventures

Are all members of consortia jointly liable for the entire project or may they allocate liability and responsibility among them?

A consortium is typically established as a form of partnership, in which case (or if it is operated so as to seem to be legally a partnership) all members will be jointly and severally liable for obligations assumed by the consortium or for which it is held liable; members of such a consortium may allocate liabilities of the consortium between themselves as they see fit, but this would not bind third parties unless they are aware of the allocation. If a consortium is established as a company then the consortium company is liable for the project to the extent of the agreements it enters into (as will the members of the consortium company be for individual contracts they enter into).

## 2 Foreign pursuit of the local market

If a foreign designer or contractor wanted to set up an operation to pursue the local market what are the key concerns they should consider before taking such a step?

A foreign designer or contractor may operate its business in Japan, if it sets up a subsidiary or a branch. In order for a subsidiary or a branch to obtain a construction licence, it needs to have an operations manager and a technical specialist, who may be a foreign national. However, for construction projects in Japan, almost all the relevant contracts, specifications, designs, and other documents are written in Japanese, as are the regulations applicable to construction projects, which are quite complicated. Therefore, it is essential to hire Japanese persons who are familiar with the practice, customs and regulations applicable to construction projects in Japan.

## 3 Licensing procedures

Must foreign designers and contractors be licensed locally to work and, if so, what are the consequences for working without a licence?

Foreign construction contractors are required to obtain one of 28 categories of construction licence to perform work in Japan. A licence issued by the minister of land, infrastructure, transport and tourism is required to establish offices in more than one prefecture, and a licence issued by the prefectural governor is required to establish an office or offices within the prefecture. Operating a construction business without an appropriate construction licence can be punished with imprisonment for not more than three years or a fine of not more than ¥3 million, or both.

Although foreign design companies themselves do not need to obtain a licence, the individuals who conduct design work for such companies are required to have obtained an architect's licence.

## 4 Labour requirements

Are there any laws requiring a minimum amount of local labour to be employed on a particular construction project?

There is no requirement for local labour to be employed on construction projects in Japan. However, in order to obtain a construction licence, a foreign contractor must show it employs engineers with a certain level of practical experience. Also, it is often difficult for a foreign national to obtain a working visa and work in Japan without special skills. As a result, foreign contractors have little choice but to rely on local labour in most cases.

## 5 Local labour law

If a contractor directly hires local labour for a project, are there any legal obligations towards the employees that cannot be terminated upon completion of the employment?

As a general rule, parties to a labour contract may agree the timing of, and consequences of, termination of the contract. However, even if the parties agree that no rights or obligations under the contract will continue after completion of the employment, unperformed obligations (eg, unpaid salaries) may continue and the contractor, foreign or otherwise, can be liable for expenses or damages arising from injuries caused during the period of employment. Also, the contractor may be required to provide social insurance (eg, medical insurance and pension insurance) for employees, and if not paid, payment may be enforced even after completion of the employment.

## 6 Close of operations

If a foreign contractor that has been legally operating decides to close its operations, what are the legal obstacles to closing up and leaving?

Since a foreign contractor needs to establish a branch office or subsidiary company in Japan in order to do business in Japan, it will be necessary to go through the process of closing the branch office and/or dissolution and liquidation of the subsidiary company when it withdraws from its Japanese business. Both require specific procedures to be followed, which can be quite time consuming and lengthy. There are no specific legal obstacles to effecting such closures, though creditors may object to the closures and will need to be dealt with.

When a foreign contractor ceases operations in Japan, it is likely that employees engaged in the project will need to be dismissed. In the case of fixed-term labour contracts, employers cannot generally dismiss employees during the term of the contract, except where there are unavoidable grounds for doing so. For labour contracts where there is no fixed term, dismissal is treated as an abuse of rights and is invalid under labour laws if it lacks objectively reasonable grounds and is not considered to be appropriate by social standards.

The closure of a branch office or liquidation of a subsidiary company is usually considered sufficient grounds for a valid dismissal,

though in practice employers need to offer substantial amounts in compensation for dismissal.

Except as stated above, there are no generally applicable obstacles to withdrawal from business in Japan.

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## 7 Construction contracts

What standard-contract forms are used for construction and design? Must the language of the contract be the local language? Are there restrictions on choice of law and the venue for dispute resolution?

Two standard forms of construction contracts are widely used, the General Conditions of Construction Contract (which is provided by a private-sector association) and the General Conditions of Construction Contract for Public Work (which is provided by the Central Council on Construction Contracting Business). The former is used if the employer is a private company and the latter if the employer is a public institution.

For design contracts, a General Conditions of Design and Supervision contract is provided by a private association, and is widely used.

There are no restrictions on choice of contract language or governing law. However, it is common practice for the Japanese language and Japanese law to be specified as the contract language and governing law because the construction work is conducted in Japan. In terms of venue for dispute resolution, Japanese law does not restrict the choice of jurisdiction or arbitration forum. However, in the General Conditions of Construction Contract for Public Work and the General Conditions of Construction Contract, the Committee for Adjustment of Construction Work Disputes is the specified forum for the resolution of disputes.

In the case of public works, even if the General Conditions of Construction Contract for Public Work is not used, it would be difficult to persuade the public institution employer to agree to the use of a foreign law, language or jurisdiction.

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## 8 Competition

Do local laws provide any advantage to domestic contractors in competition with foreign contractors?

There are no laws in Japan that provide any advantage to Japanese contractors over foreign contractors.

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## 9 PPP and PFI

Is there a formal statutory and regulatory framework for PPP and PFI contracts?

The PFI Act stipulates the basic policy and procedures of the government in promoting and operating PFI projects. The PFI Act was substantially revised in 2011 and one of the main changes was the introduction of a concession system which enables public institutions to offer business rights to the private sector in relation to public facilities. The PFI Act stipulates items that must be set forth in such concession agreements, though it does not provide any formal framework for other PFI contracts.

The PFI Promotion Office, a governmental agency, has also released a Standard PFI Contract, Guidelines on PFI Contracts, and a paper entitled Basic Approaches to Issues on PFI Contracts.

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## 10 Payment of fees

How may a contractor secure the right to payment of its costs and fees from an owner? May the contractor place liens on the property?

A contractor has a statutory right of retention with respect to the building being constructed in order to secure a claim for

construction fees or other costs. This gives the contractor the right to refuse to deliver the building until it receives payment of those fees or costs, and the right to receive payment of its construction fees and other costs from a successful bidder at any compulsory auction of the building.

Contractors also have a statutory lien on construction work to secure claims pertaining to expenses for the construction work. However, as the lien requires registration in advance, it is rarely used in practice.

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## 11 Tort claims and indemnity

Do local laws permit a contracting party to be indemnified against all acts, errors and omissions arising from the work of the other party, even when the first party is negligent?

It is possible to stipulate in contracts that a contracting party be indemnified against all acts, errors and omissions arising from the work of the other party, regardless of whether the first party was negligent in any way, and such provisions are, at least in principle, valid.

However, the Construction Industry Act requires parties to construction contracts to enter into fair contracts based on an agreement on an equal footing. Therefore, contracts that expose one party to excessive responsibility are more likely to be determined to be invalid due to violation of the principle of faith and trust. Such indemnity provisions may also become an issue in terms of abuse of a superior bargaining position. Parties should therefore exercise caution when including such clauses in agreements.

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## 12 Liability to third parties

Where a contractor constructs a building that will be sold or leased to a third party, does the contractor bear any potential responsibility to the third party? May the third party pursue a claim against the contractor despite the lack of contractual privity?

Pursuant to the Civil Code, a person whose action has negligently or intentionally infringed any right of another shall be liable to compensate that person for any damages resulting from that act. Therefore, in the context of building construction, if there is any defect in the building that causes damage to third parties, the contractor will be liable to the third parties for that damage. However, since the third parties need to prove negligence or intentional infringement by the contractor, it can be difficult to establish a liability. Nevertheless, in recent years there have been a number of cases in which courts have accepted tort liability on the part of a contractor, particularly in the case of illegal defects.

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## 13 Insurance

To what extent do available insurance products afford a contractor coverage for: damage to the property of third parties; injury to workers or third parties; delay damages; and damages due to environmental hazards? Does the local law limit contractors' liability for damages?

The extent of insurance coverage is a purely commercial matter determined by the insured. Contractors commonly purchase construction insurance (which covers damage arising from any accident, for example, fire, during the construction), damages insurance (which covers compensation claimed by a third party, for example, a third party who was injured or suffered damage to their property due to the construction by the contractor), and labour insurance (which covers injury, etc, suffered by employees of the contractor, and is in addition to the coverage by the government labour insurance). Local law does not limit contractors' liability for damages.

**14 Insolvency and bankruptcy**

Where major projects have been interrupted or cancelled, do the local laws provide any protection for unpaid contractors who have performed work?

The Civil Code provides that when bankruptcy procedures have commenced in respect of a project owner, either the contractor or the bankruptcy administrator may terminate the existing construction contract and the contractor may claim for any unpaid work in the bankruptcy procedure.

If a project is terminated without the insolvency of the project owner, the issue of unpaid fees would be dealt with as per the terms of the construction contract. Under the Civil Code, if a contract is terminated due to it being breached by a party, the breaching party must compensate the other party (or parties) for consequential damages suffered. The Civil Code also provides that the project owner may terminate the project at any time, even if the contractor has not breached the relevant contract, provided the project owner compensates the contractor for the damages it suffers as a result of the termination.

**15 Contracting with government entities**

Can a government agency assert sovereign immunity as a defence to a contractor's claim for payment?

A government agency cannot claim sovereign immunity as a defence to a contractor's claim for payment.

**16 Dispute resolution with government entities**

May government agencies participate in private arbitration and be bound by the arbitrators' award?

It is possible for government agencies to participate in private arbitration and be bound by its award, though it would be unusual for a Japanese government agency to do so.

**17 Bribery**

If a contractor has illegally obtained the award of a contract, for example by bribery, will the contract be enforceable? Are bribe-givers and bribe-takers prosecuted and, if so, what are the penalties they face? Are facilitation payments allowable under local law?

Contracts commonly stipulate that if a contractor wins a bid by collusion (eg, with other bidders to fix the bid), it can have the following effects: invalidation of the bid, the bid rigger(s) being banned from contracting for the project, invalidation of any contract already executed, and the bid rigger(s) being liable to financial penalties. In contrast, provisions regarding bids won as a result of bribery are less clear, but contracts could still be invalidated on the basis of a violation of 'public order and morals'.

Both the bribe-giver and the bribe-taker can be indicted, and the bribe-giver(s) can be punished with imprisonment for not more than three years or a fine of not more than ¥2.5 million, while the bribe-taker can be punished with imprisonment for not more than 20 years.

Furthermore, if a contractor has won a contract by an illegal act such as bribery, the contractor may be subject to administrative sanctions such as business instruction, suspension of business and/or revocation of the licence, and may also be prevented from participating in bidding on future public works projects.

Facilitation payments are not allowed and are illegal in Japan.

**18 Political contributions**

Is the making of political contributions part of doing business? If so, are there laws that restrict the ability of contractors or design professionals to work for public agencies because of their financial support for political candidates or parties?

Under the Political Funds Control Law, companies and organisations are banned from making political donations to individual politicians (including political candidates) or organisations other than political parties.

Donations to political parties do not constitute part of doing business in Japan. Therefore, contractors or design professionals cannot be subject to any restrictions when working for public agencies because of their financial support for a particular political party.

**19 Arbitration of private disputes**

What is the prevailing attitude towards arbitration of construction disputes? Is it preferred over litigation in the local courts?

There are three types of private arbitration bodies for construction disputes in Japan: the Construction Dispute Examination Board (which operates nationally, with each prefecture having its own board), the Resident Disputes Examination Board and the Arbitration Center (operated by the bar associations). Arbitration is widely used as the resolution of construction disputes as they need highly specialist experts and confidentiality is protected during the arbitration process. Court proceedings are also used in many cases.

**20 Force majeure and acts of God**

Under local law are contractors excused from performing contractual obligations owing to events beyond their control?

There are no laws or regulations pertaining to the handling of obligations in the case of force majeure in relation to construction work in Japan. Therefore, the parties are not automatically exempted from contractual obligations. However, if a construction contract specifies that the contracting parties can terminate the contract or will be exempted from performing contractual obligations in the case of force majeure events, then the contracting parties may terminate the contract pursuant to such clause and may be relieved from their obligations. It is common practice to include such provisions.

The Construction Industry Act requires a construction contract to stipulate any change in its terms or liability for damages (and the method of calculation of such damages) due to a natural disaster or other force majeure.

**21 Courts and tribunals**

Are there any specialised tribunals that are dedicated to resolving construction disputes?

The Construction Dispute Examination Board and the Resident Disputes Examination Board mentioned in question 19 are only used for construction disputes.

**22 Limitation periods**

Are there any statutory limitation periods within which lawsuits must be commenced for construction work or design services and are there any statutory preconditions for commencing or maintaining such proceedings?

The Civil Code sets a limitation period of three years from completion of the construction for claims, such as for the non-payment for work done.

**23 Dispute review boards**

Are dispute review boards (DRBs) used? Are their decisions treated as mandatory, advisory, final or interim?

Dispute review boards established for each project are not used in Japan.

**24 Mediation**

Has the practice of voluntary participation in professionally organised mediation gained acceptance and, if so, how prevalent is the practice and where are the mediators coming from? If not, why not?

The three bodies referred to in question 19 provide mediation services. There are no obstacles to voluntary participation in such mediation.

**25 Confidentiality in mediation**

Are statements made in mediation confidential?

Statements in mediation are confidential and cannot be used in subsequent litigation or arbitration; the confidentiality is contract-based, and a breaching party is liable to a penalty for its breach.

**26 Arbitral award**

Is there any basis upon which an arbitral award issued by a foreign or international tribunal may be rejected by your local courts?

The Arbitration Law in Japan provides the basis of rejection of an arbitral award issued by a foreign or international tribunal, which is the same basis provided by the New York Treaty (New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards).

**27 Governing law and arbitration providers**

If a foreign contractor wanted to pursue work and insisted by contract upon international arbitration as the dispute resolution mechanism, which of the customary international arbitration providers is preferred and why?

The Japan Commercial Arbitration Center is preferred by Japanese parties, otherwise there is no major preference for any international arbitration providers. The Singapore International Arbitration Centre is also popular because of its location and its clear rules and procedures.

**28 International environmental law**

Is your jurisdiction party to the Stockholm Declaration of 1972? What are the local laws that provide for preservation of the environment and wildlife while advancing infrastructure and building projects?

Japan is a party to the Stockholm Declaration of 1972. Japan has many laws and regulations to protect the environment, for example, the Basic Environment Law, the Water Pollution Prevention Law, the Air Pollution Prevention Law, the Soil Pollution Prevention Law, the Law on Restriction of Noise and the Environmental Assessment Law. The Environmental Assessment Law and an environmental assessment by prefectural or municipal ordinance provide for the protection of the environment and wildlife while advancing infrastructure and building projects.

**29 Other international legal considerations**

Are there any other important legal issues that may present obstacles to a foreign contractor attempting to do business in your jurisdiction?

There is no such legal issue. However, in practice, foreign contractors are not active in the construction market in Japan, mostly due to business and commercial reasons such as language, the need for local engineers, the size and competitiveness of local contractors, and the need for specialist skills, such those needed for the construction of buildings to cope with earthquakes.

**30 International treaties**

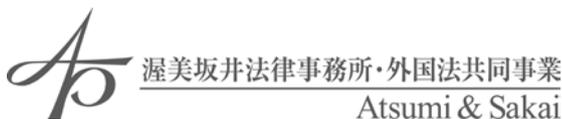
Is your jurisdiction a signatory to any investment agreements for the protection of investments of a foreign entity in construction and infrastructure projects? If so, how does your model agreement define 'investment'?

Japan is a signatory to economic partnership agreements with a number of countries. The EPAs provide stronger protection for investment into Japan, including national treatment at the approval stage. One such agreement defines 'investment' as every kind of asset, particularly including 'rights under contracts, including turnkey, construction, management, production and revenue-sharing contracts'.

**31 Tax treaties**

Has your jurisdiction entered into double taxation treaties pursuant to which a contractor is prevented from being taxed in various jurisdictions?

Japan is party to 53 double taxation treaties.

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**32 Currency controls**

Are there currency controls that make it difficult or impossible to change operating funds or profits from one currency to another?

There are no such controls in Japan.

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**33 Removal of profits and investment**

Are there any controls or laws that restrict removal of profits and investments from your jurisdiction?

There are no such controls or laws in Japan, other than transfer pricing taxation.

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**34 Contractual matrix of international projects**

What is the typical contractual matrix for a major project in your jurisdiction in terms of the contractual relationships among the various construction project participants?

Construction project participants typically form a contract-based consortium and all the members of the consortium sign a construction contract directly with the owner.

Subcontractors are commonly used for small portions of the construction work. However, in principle it is prohibited under the Construction Industry Act to use a subcontractor for all or the major portion of the construction work except in private projects, where all or the major portion of the work may be subcontracted with the owner's written consent; there is no such exception for public projects.

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**35 Local environmental responsibility**

What duties and liability do local laws impose on developers and contractors for the creation of environmental hazards or violation of local environmental laws and regulations?

Each environmental law provides a different sanction depending on the nature and seriousness of the violation, for example, a contractor that does not have a licence for the treatment and disposal of construction waste and either disposes of the waste itself or entrusts it to a company that does not have such a licence either, is liable to five years' imprisonment or a fine of up to ¥10 million.

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