

STRUCTURED FINANCE / BANKING BULLETIN

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Concession of National Airports in Japan

I. Introduction	Mori Hamada & Matsumoto
II. PFI Act Concessions	Masanori Sato
III. Airport Concession Act	+81 3 5223 7726
IV. Basic Policy on Airport Concessions	masanori.sato@mhmjapan.com
V. Summary	Shigeki Okatani
	+81 3 5220 1862
	shigeki.okatani@mhmjapan.com

I. Introduction

With a few exceptions, airports in Japan were constructed and are owned and managed directly by either the national government or local governments.¹ The Act for the Operation of Government Controlled Airports by Private Sector Entities (Act No. 67 of 2013, the “**Airport Concession Act**” or the “**Act**”), which took effect on July 25, 2013, now allows the private sector to operate airports by way of a concession under the PFI Act² (the “**PFI Act Concession**”). On November 1, 2013, the Ministry of Land, Infrastructure, Transport and Tourism (the “**MLIT**”) promulgated the Basic Policy on the Operation of Government Controlled Airports by Private Sector Entities (the “**Basic Policy on Airport Concessions**” or the “**Basic Policy**”) which provides the basic framework for airport concessions.

The government is now considering the privatization of Sendai Airport and recently released the draft of the concession scheme for Sendai Airport (the “**Draft Scheme**”). A market sounding for the airport was conducted in November and December last year.

In this bulletin, we will provide an overview of the PFI Act Concession (Section II below) and the Airport Concession Act (Section III below), as well as explain the Basic Policy and point out some noteworthy information on the Draft Scheme (Section IV below).

¹ Strictly speaking, airports mean basic aeronautical facilities such as runways, aprons and navigation facilities, and do not include airport terminals and car parking facilities. In many airports in Japan, airport terminals and car parking facilities were constructed and are owned and managed by private or “third sector” entities. A “third sector” is a company jointly owned by a local government and private entities. See Sections III.2.(3) and III.3 below for details.

² Act on the Promotion of Private Finance Initiative (Act No. 117 of 1999).

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II. PFI Act Concessions

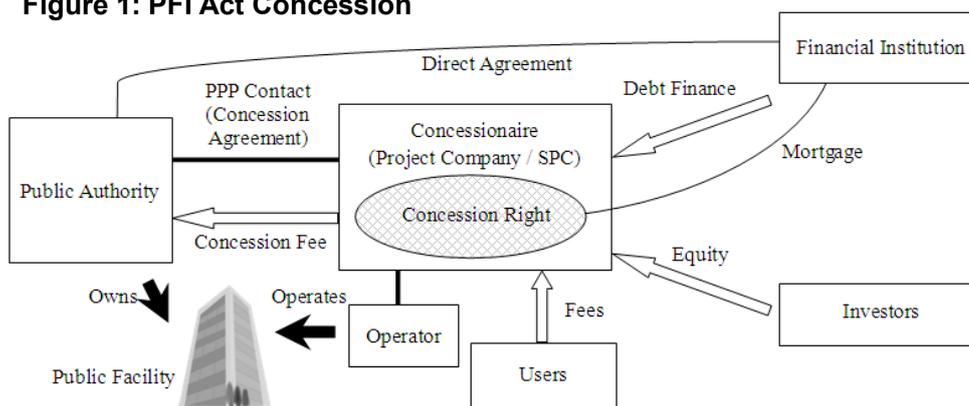
Under the Airport Concession Act, in principle, the privatization of airports should be done through a PFI Act Concession.

The 2011 revisions to the PFI Act introduced PFI Act Concession as a new type of PFI.³ Under a PFI Act Concession project, a public entity which administers public facilities (the “**Public Authority**”) confers the right to operate those facilities (the “**Concession Right**”) on a private entity (the “**Concessionaire**”). The Concessionaire is allowed to charge the users fees for using the public facilities. This means that the Concessionaire itself determines the fees and earns the collected fees as its own income.

Further, a Concession Right is deemed as “real property” under Japanese law; thus, the Concessionaire may transfer it to another private entity and create security interests over it. In fact, a registration system for PFI Act Concessions, similar to a real property registration system, has been introduced. From an accounting perspective, the Concession Right is recognized as a depreciable asset.

Under the PFI Act, a PFI Act Concession project must be structured so that the Concessionaire makes its earning from user’s fees (payable by users) rather than service fees or availability payments (payable by a Public Authority).⁴

Figure 1: PFI Act Concession



³ In Japan, public-private partnership (PPP) projects implemented under the PFI Act, including concessions and user-pays projects, are all called private finance initiatives (PFIs).

⁴ The leading view seems to be that the so-called “combined projects”, where the project income comes from service fees payable by public entities as well as fees payable by users, are permitted within the framework of the PFI Act Concession under the PFI Act (see Yasuyuki Kurano and Masatomo Miyazawa, *Kaisei PFI Ho no Gaiyou (7 kan)* [Overview of the Revised PFI Act (VII)], Kinyu Homu Jijo, Vol. 1932, p. 139).

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III. Airport Concession Act

1. Significance of the Airport Concession Act

The leading view was that under the Airport Act and the Civil Aeronautics Act, a private entity is not allowed to operate an airport.⁵ This view did not change with the introduction of the PFI Act Concession in 2011 because the PFI Act does not override these acts. In sum, whether a private entity may operate a public facility depends on the law governing the facility (“*koubutsu-kanri-ho*” or public property management laws). However, with the Airport Concession Act, Concessionaires may now operate airports under a PFI Act Concession.

In general, the privatization of airports may take various forms, such as selling shares in a corporation, listing or forming capital alliances with other airport operators. However, the government chose to privatize airports through PFI Act Concessions in order to maintain a certain level of control over airports by keeping the ownership of airport facilities and lands. This level of control is viewed as necessary from the perspective of disaster response, national security, crisis management and infrastructure development.⁶

2. Background of the Airport Concession Act

The Airport Concession Act was born out of the need to reform airport management.

(1) Efficient management of airports

Recent years have seen the need to operate airports more efficiently. Even with no prospect of an increased demand in domestic air travel due to a decreasing and aging population in Japan, airport facilities need to be maintained and updated, which requires huge financial outlay. In addition, significant changes in the airline industry, particularly the liberalization of the civil aviation market to introduce open skies and the emergence of low cost carriers (LCCs), led both airlines and their passengers to demand more flexible airport services at lower cost.

⁵ Please see footnote 1 on the use of the word “airport”.

⁶ These considerations were raised by government officials during discussions in the parliament and in the Basic Policy (Basic Policy, Section 1.1(2)).

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(2) Independent accounting of each airport

The government realized the importance of an independent accounting of each airport and a flexible airport management system. Under the current system, income from airport charges such as landing fees at all national airports is managed within a single national pool⁷ (i.e., the airport development sub-account under the social infrastructure development special account). In principle, airport charges are the same in all national airports in Japan, and each airport cannot set its own airport charges. Under the Airport Concession Act, however, an airport Concessionaire of a specific airport may set its own airport charges and collect them as income.

(3) Management integration of aeronautical and non-aeronautical operations

The authorities recognized the need to integrate the management of aeronautical and non-aeronautical operations in the efficient management of airports. In many airports in Japan, the government owns and operates basic aeronautical facilities, such as runways, aprons and navigation facilities, while private or third sector entities own and operate non-aeronautical facilities such as airport terminals and car parking facilities. Accordingly, the government cannot offer lower airport charges to airlines by generating income from non-aeronautical operations. By introducing the Airport Concession Act and the Basic Policy, the government now aims to have one Concessionaire manage both aeronautical and non-aeronautical operations under its concession.⁸

3. Airports subject to the Airport Concession Act

Airports in Japan are classified as (i) “National Airports” established and managed by the national government⁹ (19 airports), (ii) “Special Regional Airports” established by the national government but managed by local

⁷ This system contributed to the development of airports in Japan in the past as it enabled the government to use the revenues from profitable airports to build new airports throughout Japan. But it has also been criticized as creating a feeling of unfairness among the users of profitable airports in the urban areas and those of unprofitable airports in the countryside, and people suspect that the system enabled politicians to open unnecessary airports.

⁸ There are no provisions in the Airport Concession Act on the management integration of aeronautical and non-aeronautical operations. However, an integrated management was assumed in parliamentary discussions, and is a key policy under the Basic Policy as will be explained below.

⁹ While “National Airports” under the Airport Act include Special Regional Airports, “National Airports” as defined under the Airport Concession Act do not include Special Regional Airports (Article 2, paragraph 1 of the Act). In this bulletin, National Airports and Special Regional Airports are distinguished pursuant to the Airport Concession Act.

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governments (5 airports), (iii) “Incorporated Airports” established and managed by corporations under special laws (Narita, Kansai, Itami, and Chubu airports)¹⁰ (iv) “Regional Airports” established and managed by local governments (54 airports), (v) “Airports for Joint Use” managed by either the Self-Defense Forces of Japan or the Armed Forces of the United States jointly with the national government (8 airports), and (vi) other minor airports.

A concession under the Airport Concession Act¹¹ covers (i) National Airports (Act, Article 4, et seq.) such as Sendai Airport, (ii) Regional Airports (Act, Article 10, et seq.), (iii) civil aviation facilities at Airports for Joint Use (Supplementary provisions of the Act, Article 2, et seq.), and (iv) other minor airports established and managed by local governments (Act, Article 10, et seq.).¹²

Incorporated Airports are not subject to the Airport Concession Act. However, the government has enacted another special legislation¹³ for the concession of the Kansai International Airport and the Osaka (Itami) International Airport. The national government and the New Kansai International Airport Co., Ltd. are currently preparing for the concession of those airports.

4. Scope of airport operation by Concessionaires

Under the Airport Concession Act, the following businesses may be conducted by Concessionaires during the concession period: (i) managing aeronautical facilities and collecting airport charges, (ii) managing airport air navigation facilities and collecting usage fees for those facilities, (iii) implementing measures against aircraft noise, (iv) implementing necessary measures in the surrounding areas, and (v) businesses incidental to the foregoing businesses (Act, Article 2, paragraph 5). The actual scope of the business of a

¹⁰ Narita International Airport Corporation managing Narita International Airport, and New Kansai International Airport Co., Ltd managing Kansai International Airport and Osaka (Itami) International Airport are wholly owned by the national government. Central Japan International Airport Co., Ltd managing Central Japan (Chubu) International Airport is owned by the national government (39.99%), local governments (Aichi Prefecture, 5.87%; and Nagoya City, 2.83%) and private businesses. (The figures are as of March 31, 2013)

¹¹ Instead of a PFI Act Concession, a local government may allow a private entity to operate a Special Regional Airport under a “special designation system” under Article 14 of the Supplementary Provisions of the Airport Concession Act.

¹² For brevity, in principle, this bulletin will cite provisions concerning the concession of National Airports although the Airport Concession Act also has provisions for the concession of Regional Airports and other minor airports.

¹³ The Act for the Integrated and Effective Establishment and Management of Kansai International Airport and Osaka International Airport.

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Concessionaire will be set out in an Implementation Policy¹⁴ for each airport (PFI Act, Articles 5 and 17).

5. Special exceptions to the Airport Act, the Civil Aeronautics Act, the PFI Act and other laws

The Airport Concession Act contains special exceptions to the Airport Act, the Civil Aeronautics Act, the PFI Act and other laws to allow Concessionaires to manage airports.

The most important aspect is that, in principle, Concessionaires have the discretion to fix charges but must file an *ex post facto* notification to the Minister of MLIT (see Act, Article 8, paragraph 2, et seq., and Airport Act, Article 13, paragraph 1). However, if the fees are (i) unjustly discriminative or (ii) extremely inappropriate and the use of the airport is likely to be extremely limited, the Minister of MLIT may issue an order to the Concessionaire to change the fees (Act, Article 8, paragraph 2, and Airport Act, Article 13, paragraph 2). As explained below in Section IV.6, under Section 2.8 of the Basic Policy, the setting of fees is basically up to the initiative and innovation of the Concessionaire, but we should monitor how often the government will issue orders for a change of fees.

In addition, the Ordinance for Airport Operations (Ordinance of the Ministry of Transport No. 44 of 1952), which sets out basic matters on the management of National Airports, does not apply to airports privatized by PFI Act Concession (Ordinance for the Implementation of the Act, Art. 4), and instead Concessionaires must formulate, announce to the public, and notify the MLIT of, the Airport Operation Rules under the Airport Act (Act, Article 8, paragraphs 1 and 2, and Airport Act, Article 12). Further, a Concessionaire must be a member of the Airport Council of the airport it operates, and participate in discussions on airport operations (Act, Article 8, paragraph 1, and Airport Act, Article 14, paragraph 2, item (ii)). The members of this council are local governments and local business associations. . Hence, the airport operation by a Concessionaire has to reflect, or at least respect, local public opinions and local economic interests. In practice, the support of the local government is a precondition to an airport concession.

¹⁴ An "Implementation Policy" is a document published by a Public Authority at the beginning of the bid procedure for a specific PFI project which describes the purpose, scope and structure of the project and the details of the bid procedure.

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The Act provides that the national government will hear the opinion of the relevant Airport Council (Act, Article 5, paragraph 3) in formulating the Implementation Policy for each subject airport, and each concession project will be implemented in consideration of various conditions in the region and local public opinions.

IV. Basic Policy on Airport Concessions

While the Airport Concession Act removed regulatory obstacles without presenting the details of concession projects, the Basic Policy on Airport Concession provides for the basic structure of the PFI Act Concession of National Airports under the Airport Concession Act. The following are the details of the Basic Policy with some notes on the Draft Scheme for the concession of Sendai Airport.

1. Significance and goals of airport concessions

The Basic Policy first sets out the significance of airport concessions by describing the background of the enactment of the Airport Concession Act and explaining the necessity for effective airport management utilizing skills of the private sector (Basic Policy, Section 1.1(1)).

When privatizing a National Airport, the government must aim to increase the total value of the airport by having a Concessionaire¹⁵ integrally manage both the aeronautical and the non-aeronautical operations (*Id.* Sections 1.1(2) and 3.2(1)). It has also been suggested that the government may choose the so-called “bundling” of airports in which Concession Rights for multiple airports are granted to a single Concessionaire (*Id.* Section 1.1(2)).

The Basic Policy also sets out the targets to be achieved through airport concessions such as regional development, increased convenience for airlines and passengers, and increased value of airports (*Id.* Section 1.2).

The Basic Policy also requires Concessionaires to coordinate with the national government, local governments, and airport related businesses and contribute

¹⁵ A Concessionaire must be a special purpose company established by a consortium of sponsors selected through a bid procedure and dedicated only to the management of the subject airport (see Basic Policy, Section 3.2(1)).

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to the efficiency of airport management in light of the legislative intent of the PFI Act (*Id.* Section 4).

2. Scope of airport operation projects by private business operators

Under the Basic Policy, in principle, Concessionaires will conduct the following operations (*Id.* Section 2.1):

- (i) Airport operations such as the operation and maintenance of runways, removal of obstacles, airport security, and airport fire defense, in return for which the Concessionaire collects airport charges as its own income;
- (ii) Management of air navigation facilities at airports such as the operation and maintenance of aeronautical lights and incidental electrical equipment, in return for which the Concessionaire collects usage fees as its own income;
- (iii) Taking measures to control aircraft noise at Specified Airports as provided in the Aircraft Noise Control Act;¹⁶
- (iv) Incidental businesses to the above;
- (v) Operation of car parking facilities on airport sites; and
- (vi) Operation of airport facilities such as terminal buildings.

It should be noted that the Basic Policy provides that a Concessionaire or its subsidiary must conduct the operations described in items (v) and (vi) above by acquiring the ownership of the facilities (see Figure 2 below) from the existing private or third sector operators.¹⁷ Like existing terminal building operators, to own those facilities, the Concessionaires must have a permission for use of land or land leasehold rights from the national government with respect to the sites of those facilities. It is also necessary to note that, during the concession period, in addition to acquiring Concession Rights, the Concessionaire must also be designated as an Airport Facility Operator by the Minister of MLIT under the Airport Act (Airport Act, Article 15).

¹⁶ The Act on the Prevention of Damage caused by Aircraft Noise in Areas around Public Airports (Act No. 110 of 1967).

¹⁷ However, the requirement for a Concessionaire to acquire ownership of non-aeronautical facilities does not apply to Incorporated Airports such as Kansai and Itami Airports because their respective operators own and operate the non-aeronautical facilities as well as the aeronautical facilities. In other words, the granting of a Concession for Kansai and Itami Airports will enable the Concessionaire to operate both aeronautical and non-aeronautical facilities without any further action on the part of the Concessionaire.

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Figure 2: Ownership and operation of airports under the current system and a Concession

<Current System>			<Under a Concession>		
	Aeronautical facilities	Non-aeronautical facilities		Aeronautical facilities	Non-aeronautical facilities
Owner	Government	Third sector	Owner	Government	Concessionaire
Operator	Government	Third sector	Operator	Concessionaire	Concessionaire

In the case of Sendai Airport, the Draft Scheme provides that the Concessionaire must acquire the airport's passenger terminal and the cargo terminal from existing operators by purchasing either the outstanding shares of the operators or their assets and business (Draft Scheme, Section 1.(6)). The government will enter into an acquisition agreement with the operators before the bid and transfer that agreement to the Concessionaire after the bid. In addition, in principle, the Concessionaire has to keep the employees of the operators under conditions which are not less favorable to those employees compared to the current conditions of employment (*Id.*).

3. Concession period

The Basic Policy suggests that the concession period will be approximately between 30 years and 50 years (Basic Policy, Section 2.2), although the government has the flexibility to fix the period taking into account various factors such as the conditions in the region and full utilization of the innovation of each Concessionaire (*Id.*).

Section 1(5) of the Draft Scheme for the concession of Sendai Airport provides that the concession period will be 30 years initially and the Concessionaire has the option to extend it once at its convenience for an additional period of up to 30 years. The Concessionaire and the government may also extend the concession period as may be necessary to allow the Concessionaire to recover additional costs or losses caused by force majeure events. But in no case may the total concession period exceed 65 years.

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4. Capital investment in airport facilities

The Basic Policy provides that a Concessionaire must make capital investments to repair or renovate runways and air navigation facilities under the project agreement with the government (Basic Policy, Section 2.4). But if a Concessionaire invests in a runway or an air navigation facility owned by the national government, the national government will own that improved or expanded part (*Id.*).

In addition, the Basic Policy provides that a Concessionaire may invest, at its discretion, in airport facilities such as terminal buildings to increase the function and convenience of the airport to increase the value of the airport (*Id.*).¹⁸

On the other hand, the national government may introduce facility developments that are not made by the Concessionaire if it determines such developments to be necessary in light of public interest (*Id.*).

5. Risk allocation – force majeure

In relation to the risk allocation between the government and a Concessionaire in case of large-scale disasters, the Basic Policy states that the government will predetermine the type and scale of disasters for which the Concessionaire will take the risk. The Concessionaire will be responsible for the recovery of the airport from disasters based on the government's predetermination (Basic Policy, Section 2.5). The Concessionaire is also required to be covered by insurance for the risk of disasters allocated to the Concessionaire (*Id.*). The government will, at its cost, take on recovery work from disasters beyond the extent allocated to the Concessionaire if the government decides that such further recovery work is necessary (*Id.*).

For the concession of Sendai Airport, the Draft Scheme basically takes the same approach as the Basic Policy on the risk allocation between the government and the Concessionaire in case of force majeure events including earthquakes and tsunamis. When a force majeure event occurs, the government will consider whether the disaster is beyond the extent allocated to the Concessionaire, thus the government needs to take measures to enable Sendai

¹⁸ Under the Draft Scheme, the Concessionaire must include plans for those investments in the annual business plan and the 5-year mid-term business plan it must submit to the government yearly and every 5 years, respectively.

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Airport to continue (Draft Scheme, Section 1.(17)). The government will make that determination only if all or most of the damages to the facilities cannot be covered by the Concessionaire's insurance (*Id.*). If the government decides that it needs to take business continuity measures (i.e., the disaster is beyond the Concessionaire's risk allocation), the government will take on recovery work (*Id.*). If the government decides to the contrary, the Concessionaire will be responsible for the recovery of all the facilities (*Id.*).¹⁹

6. Airport charges

A Concessionaire may set airport charges such as landing fees at its discretion as long as the charges will not considerably increase the burden on air carriers and users (*Id.* Section 2.8).

7. Selection of Concessionaires

During the bid process, the government will closely check company and financial information of the bidders, and will confirm that the selected bidder has a reliable plan for air transport security, increased user convenience, contributions to regional development and business continuity, and specific proposals on airport charges (*Id.* Section 2.10).

Unqualified bidders will be excluded considering that airports are important public infrastructure involving national security and crisis management, are at the center of disaster relief actions, and are regional hubs for wide-area interchange (*Id.*). These factors however are undeniably subjective in nature. Thus, the government must ensure fairness and transparency when exercising its judgment.

8. Calls for private sector proposals

Following the promulgation of the Basic Policy, if necessary, the government may hold a so-called market sounding to invite public proposals and comments on the concession of a specific airport (*Id.* Section 5). The national government will try to disclose as much information in its possession as can be disclosed

¹⁹ The Draft Scheme provides that if the government decides that there is no need for recovery work by the government, the Concessionaire will be responsible for the recovery of all the facilities (Draft Scheme, Section 1.(17)). This provision seems to refer to a case where the government finds the disaster to be within the extent of risk allocated to the Concessionaire.

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and ensure that those private sector proposals will not be legally binding (*Id.*). The results of the market sounding will be reflected in the Implementation Policy of the concession of that airport and, if necessary, in a review of the Basic Policy in the future (*Id.*).

In respect of the concession of Sendai Airport, the government conducted a market sounding from November to December last year. The government is expected to draft the Implementation Policy in a few months to reflect comments and proposals submitted by potential bidders during the market sounding.

V. Summary

Following the Airport Concession Act taking effect in July 2013, the Basic Policy was announced and the basic structure of airport concessions was clarified as we discussed above. The government will consider the concession of specific National Airports under the Basic Policy, with Sendai Airport expected to be the first.

Mori Hamada & Matsumoto will closely monitor future developments in this area so that we are able to provide the latest information and legal advice based on that information.

(Contacts)
Public Relations
mhm_info@mhmjapan.com
+81-3-6212-8330
www.mhmjapan.com