

STRUCTURED FINANCE / BANKING BULLETIN

January 2014

Recent Developments in Public-Private Partnerships in Japan

I. Dawn of a New Era of Public-Private Partnerships in Japan	Mori Hamada & Matsumoto Masanori Sato +81 3 5223 7726 masanori.sato@mhmjapan.com
II. Recent Developments in PPPs	
III. Revisions to Guidelines for PFI Projects	Shigeki Okatani +81 3 5220 1862 shigeki.okatani@mhmjapan.com
IV. Concession Guidelines	
V. Response to Diversification of PFI Projects and Use of Large-Scale PFI Projects	Noriya Udagawa +81 3 6266 8587 noriya.udagawa@mhmjapan.com
VI. Improving the Procurement Process	
VII. Conclusion	

I. Dawn of a New Era of Public-Private Partnerships in Japan

The new year 2014 will mark the beginning of a new era of public-private partnerships (“**PPPs**”) in Japan. Last year, there were significant movements to improve the legal and regulatory framework of the Japanese PPP, and the national government and the local governments started studying the possibility of adopting the concession type of PPP to privatize their infrastructure. In this Bulletin, we feature recent developments in PPPs and private finance initiatives (“**PFI**s”)¹ in Japan and recent revisions to the guidelines for PFI projects to give you a better understanding of PPPs in Japan.

II. Recent Developments in PPPs

1. Action Plan for Fundamental Reforms of PPPs/PFIs

The Council for the Promotion of Private Finance Initiatives of the Cabinet Office established the “Action Plan for Fundamental Reforms of PPPs/PFIs” on June 6, 2013.² This action plan aims to intensively promote PPP/PFI projects to

¹ In Japan, PPP projects implemented under the Act on Promotion of Private Finance Initiative (Act No. 117 of 1999, the “**PFI Act**”), including concessions and user-pays projects, are all called PFIs.

² The implementation of that action plan is also set out in the government’s growth strategy. Please see “Basic Policies for Economic and Fiscal Management and Reform – Ending Deflation and Revitalizing the Economy” dated June 14, 2013 (published by the Government of Japan) p. 24 (pp. 27 and 28 in the English version), and “Japan Revitalization Strategy – Japan is Back” dated June 14, 2013 (published by the Government of Japan) p. 48 (p. 68 in the English version)).

STRUCTURED FINANCE / BANKING BULLETIN

achieve a more efficient operation or renovation of infrastructure, enhance the level of services and reduce government fiscal burdens. The action plan presents specific project types and size targets (totaling JPY 10–12 trillion over the next ten years from 2013 to 2022) as follows:

- (1) **Concessions**: JPY 2–3 trillion
 <Specific measure> Active promotion of concessions under the PFI Act (“**PFI Act Concessions**”) in airport, water and sewage projects
- (2) **Public facilities with income-producing facilities**: JPY 3–4 trillion
 PFI projects for the construction, renovation, maintenance or operation of public facilities which, together with income-producing facilities attached to them, may generate sufficient revenues to cover the costs associated with those projects.
 <Specific measure> Studying the use of PPPs for the maintenance and renewal of public facilities such as expressways (especially the *Shutoko* Metropolitan Expressway, which requires major repairs)
- (3) **PPP projects based on private proposals**: JPY 2 trillion
 PPP projects that adopt proposals from the private sector, for example, for the effective utilization of unused or underused public real estate.
- (4) **Other project types**: JPY 3 trillion
 Other conventional types of PPP projects in which measures to reduce government fiscal burdens are to be pursued, such as structuring facility management fees based on revenues generated from the project (i.e., as opposed to availability-based fee arrangement³) or combining the renovation and maintenance of multiple facilities.

³ These are payments from a Public Authority to a project company that meets certain requirements including, typically, making the facility available to users.

STRUCTURED FINANCE / BANKING BULLETIN

2. Airport Concession

The Act for the Operation of Government Controlled Airports by Private Sector Entities (the “**Airport Concession Act**”) came into effect on July 25, 2013. This law provides for exceptions to the Airport Act and other related laws to allow the private sector to operate government-established or -controlled airports. Under this law, the privatization of airports should be achieved through PFI Act Concessions.

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 Entities (the “**Basic Policy for Airport Concession**”) which provides the basic framework for airport concessions.⁴ Under the Basic Policy for Airport Concession, a concessionaire must operate an airport integrally, including non-aeronautical facilities such as passenger and cargo terminals and automobile parking facilities. In this respect, it should be noted that in practice, non-aeronautical facilities are owned and operated by third sector⁵ entities while aeronautical facilities such as runways, aprons and air traffic control towers are owned and operated solely by the government.

MLIT is said to be studying the possibility of using concessions for several government-controlled airports. In particular, Sendai Airport is reported to be the first concession project under the Airport Concession Act, with MLIT conducting a market sounding for this project from late November to December 20 last year.

At the same time, the government is considering using a concession to privatize Kansai International Airport and Osaka International (Itami) Airport⁶ under a special law.⁷

⁴ See Mori Hamada & Matsumoto, “Announcement of Draft Basic Policy on the Operation of Government Controlled Airports by Private Sector Parties,” *Structured Finance/Banking Bulletin October 2013* (in Japanese), for details of the Basic Policy for Airport Concession. An English version will be published soon.

⁵ In Japan, the “third sector” means companies jointly owned by local governments and private entities.

⁶ The two airports are currently owned and operated by New Kansai International Airport Company, Ltd., which is wholly owned by the national government.

⁷ See, the Act for the Integrated and Effective Establishment and Management of Kansai International Airport and Osaka International Airport. The Act provides for the merger of the two airports, which was completed in July 2012, and the use of concessions to privatize the merged airports.

STRUCTURED FINANCE / BANKING BULLETIN

3. Water Concession

On November 11, 2013, Osaka City, the third largest city in Japan with a population of 2.6 million, decided to draft a basic policy as early as March 2014 to privatize its water services by utilizing a PFI Act Concession. According to its preliminary report, the City will give the concession right to a project company as early as 2015. The project company will provide water services for around 30 years under the concession agreement with the City. It will be wholly owned by the City at the beginning but will accept private investments in 5 years.

4. Sewage Concession

The Study Group on the Utilization of PPP/PFI in the Operation of Sewage Facilities, which was set up by MLIT in December 2012, has been discussing further utilization of PPPs in sewage operations including concession. The study group published a brief interim report in April 2013, which itemized issues and presented the direction of future discussions, and is currently drafting guidelines for sewage concession. The draft guidelines are scheduled to be published and open for public comments this month.

5. Creation of an Infrastructure Fund Co-sponsored by the Public and the Private Sectors

The Private Finance Initiative Promotion Corporation of Japan (the “**PFIPCJ**”) was incorporated on October 7, 2013 under the 2013 Revised PFI Act.⁸ The PFIPCJ is co-sponsored by the national government and private entities such as banks and insurance companies. The 2013 Revised PFI Act requires the PFIPCJ to provide debt, equity funding and other support to PFI projects. It should be noted that, under the revised law, the project should be the “user-pay” type and the PFIPCJ cannot support projects which rely on availability payments from public authorities. The PFIPCJ aims to financially support PFI projects mainly by “mezzanine” financing (which will primarily take the form of mezzanine debt or preferred shares in project companies), as indicated in the support criteria established by the government under the 2013 Revised PFI Act and promulgated on October 4, 2013.

⁸ The PFI Act was revised in 2011 and 2013. If specific revisions are relevant to the discussion in this Bulletin, the law will be referred based on the year of revision, i.e., 2011 Revised PFI Act and 2013 Revised PFI Act, while the phrase “PFI Act” refers to the law as a whole including all revisions.

STRUCTURED FINANCE / BANKING BULLETIN

The PFIPCJ is expected to promote equity investments in PFI projects and nurture the infrastructure investment market by using national funds as seed money. The user-pay type of PFI projects is expected to reduce the national deficit and create business opportunities for the private sector.⁹

III. Revisions to Guidelines for PFI Projects

On June 6, 2013, the Cabinet Office revised the following PFI guidelines. The most important revision is the establishment of the Concession Guidelines which give the first detailed guidance on PFI Act Concessions.

- Guidelines for Concession Right and Operation of Public Facilities (new)
(the “**Concession Guidelines**”)
- Guidelines for the PFI Project Implementation Process (revised)
(the “**PFI Procurement Process Guidelines**”)
- Guidelines for Contracts – Matters to be Considered in PFI Project Contracts (revised)
(the “**PFI Contract Guidelines**”)

In the following sections, we will first give an overview of the Concession Guidelines (Section IV). Then, we will explain the revisions to the PFI Procurement Process Guidelines and the PFI Contract Guidelines in response to the diversification of PFI projects and use of large-scale PFI Projects (Section V). Finally, we will explain the revisions to the PFI Procurement Process Guidelines aimed to utilize the private sector’s skills and give the private sector more incentives to get involved in PFI projects (Section VI).

IV. Concession Guidelines

The revised PFI Basic Policy¹⁰ issued in 2012 provided for basic guidance for contracting authorities. But there was no detailed guidance for concessions, and no PFI Act Concessions under the 2011 Revised PFI Act closed in Japan.

⁹ See “Japan Revitalization Strategy – Japan is Back” dated June 14, 2013 published by the Government of Japan, pp. 48 and 49 (pp. 68 and 69 in the English version).

¹⁰ “Basic Policy for the Implementation of PFI Projects” adopted by the cabinet pursuant to Article 4, paragraph 1 of the PFI Act.

STRUCTURED FINANCE / BANKING BULLETIN

The Concession Guidelines provided the first detailed guidance on practical matters and interpretation of laws on PFI Act Concessions.

The Concession Guidelines cover a broad range of issues, but we will focus on the following several notable legal issues.

1. PFI Act Concessions

In Japan, a concession is a type of PFI project under the PFI Act. Under a PFI Act Concession, 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**”). It should be noted that while the Concessionaire conducts the “Operation of Public Facilities” (see PFI Act, Article 2, paragraph 6), the construction of the facilities is outside the scope of the PFI Act Concession (see Subsection 5 below).

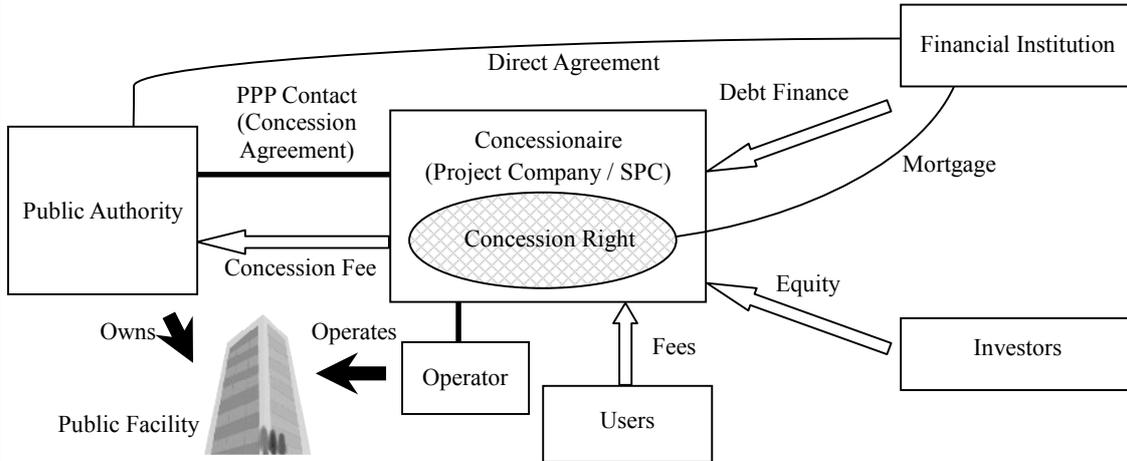
The Concessionaire is allowed to charge the users fees for using the public facilities. This means that the Concessionaire itself determines the fees and earns the collected fees as its own income. Further, a Concession Right is deemed as “real property” under Japanese law; thus, the Concessionaire may 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 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).¹¹

¹¹ The authority seems to be of the view 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 a 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). Please note that the limitation on income source is applicable only to PFI Act Concessions. In other types of PFI projects such as BTO, the project company may rely on availability payments from the Public Authority, which has been the more typical scheme in Japan.

STRUCTURED FINANCE / BANKING BULLETIN

Figure: Concession



2. Concessionaire’s Right to Use Public Facilities

During the concession period, the Public Authority continues to own the public facilities. In this regard, the Concession Guidelines clarify that a Concession Right includes the right to use the public facilities covered by the concession (the “**Subject Public Facilities**”) to the extent necessary for the Concessionaire to operate those public facilities. Section 6(1)2 of the Concession Guidelines sets out the relationship between a Concession Right and the right to use Subject Public Facilities.

Table 1: Relationship between a Concession Right and the Right to Use Public Facilities

	Cases described in the Concession Guidelines	Whether Concessionaire’s use of public facilities is within the scope of the Concession Right	Whether another arrangement is necessary in addition to the project agreement
(1)	Concessionaire uses the Subject Public Facilities in the ordinary course of the operation of such facilities	Yes (within the scope of the Concession Right)	Not necessary
(2)	Concessionaire uses the site of the Subject Public Facilities in the ordinary course of the operation of such facilities	Yes (within the scope of the Concession Right)	Not necessary
(3)	Concessionaire leases part of a building, which	No (outside the scope of the Concession)	The Concessionaire must enter into a lease

STRUCTURED FINANCE / BANKING BULLETIN

	is part of the Subject Public Facilities, to a tenant	Right)	agreement ¹² with the Public Authority under the National Property Act or other applicable law before it may sublease the building to a tenant.
(4)	Public Authority leases a site to the Concessionaire on which the Concessionaire will construct a building in relation to the operation of the public facilities	No (outside the scope of the Concession Right)	The Concessionaire must have a lease agreement with or permission to use from the Public Authority under the National Property Act or other applicable law.
(5)	Concessionaire uses a site for the purpose of a project that is not included in the Concession Right	No (outside the scope of the Concession Right)	The Concessionaire must have a lease agreement with or permission to use from the Public Authority under the National Property Act or other applicable law.

We emphasize case (3) above. Under the Concession Guidelines, even if the Concessionaire subleases part of a public building to a tenant *as part of the operation of a public facility*, the Concessionaire must enter into a lease agreement¹³ with the Public Authority before it subleases the building to tenants. Not only will the Concessionaire have the additional procedural burden of entering into a lease agreement,¹⁴ in addition to the project agreement for the Concession Right, but it will be subject to restrictions¹⁵ under the National Property Act or other laws governing the lease of government property.

¹² It is also possible to have a lease without consideration (free rent) or just permission to use, although the government appears to take the view that the concession fee payable by the Concessionaire to the Public Authority should be specifically structured so as to include the consideration for the lease or permission to use (see Cabinet Office, PFI Promotion Committee, 32nd Coordination Subcommittee Meeting Minutes, pp.10–12 [statement by Mr. Kodama, Deputy Director of the Cabinet Office]).

¹³ *Id.*

¹⁴ A member of the PFI Promotion Committee suggested that it is possible to incorporate such a lease agreement into a project agreement (see Cabinet Office, PFI Promotion Committee 32nd Coordination Subcommittee Meeting Minutes, pp.10–12 [statement by Mr. Kodama, Deputy Director of the Cabinet Office]).

¹⁵ For example, Article 21 of the National Property Act limits the lease terms for buildings to a maximum of 10 years.

STRUCTURED FINANCE / BANKING BULLETIN

3. Evaluating the Concession Fee

The Public Authority may charge the Concessionaire a concession fee for the Concession Right.¹⁶ Any concession fee, if charged, will be determined based on the net present value of the project to be calculated by the discounted cash flow (DCF) method, subject to adjustment by factors such as the risks and advantages of the project (Concession Guidelines, Section 7(1)2–2.(1)).

4. Concession of Public Facilities Owned by Local Governments; Designated Public Facility Manager

Under the Local Government Act, before a private person may operate public facilities owned by a local government, it must first be appointed as a “**Designated Public Facility Manager**” (Local Government Act, Article 244-2, paragraph 3). A Designated Public Facility Manager has the authority to allow the use of public facilities by users for a fee charged in accordance with the local ordinance. This rule applies to the operation of public facilities by a Concessionaire under a PFI Act Concession. In other words, a PFI Act Concession does not exempt the Concessionaire from regulations under the Local Government Act on Designated Public Facility Managers. Thus, there is apparently an overlap between the regulations under the Local Government Act and the PFI Act Concession, which overlap requires the Concessionaire to also be a Designated Public Facility Manager. Therefore, it is desirable that the same conditions apply to the procedures for the appointment of a Designated Public Facility Manager and the grant of a PFI Act Concession (e.g., duration and scope of business) in order to reduce administrative burdens that may otherwise arise from dual regulations (Concession Guidelines, Section 9(2)2.(3)).

The Concession Guidelines address this overlap.

First, the Concession Guidelines allow a local government or its assembly to integrate the processes required to be undertaken for the appointment of a Designated Public Facility Manager and the grant of a PFI Act Concession. More specifically:

¹⁶ The Public Authority may also decide not to charge a concession fee (Concession Guidelines, Section 7(1)2–1.(6)).

STRUCTURED FINANCE / BANKING BULLETIN

- (a) A local government may submit to the local assembly all bills to enact the local ordinances required for the appointment of a Designated Public Facility Manager and the grant of a PFI Act Concession as a single integrated bill (Concession Guidelines, Section 9(2)2.(1)). These local ordinances pertain to (i) the framework for the PFI Act Concession of the public facilities (PFI Act, Article 18), (ii) the rules of the Designated Public Facility Manager system of that local government (Local Government Act, Article 244-2, paragraph 3) and (iii) the rules of the fees which the Designated Public Facility Manager may charge users (Local Government Act, Article 244-2, paragraph 9).

- (b) The local assembly may pass the resolution conferring the Concession Right (PFI Act, Article 19, paragraph 4) and the resolution appointing the Concessionaire as the Designated Public Facility Manager (Local Government Act, Article 244-2, paragraph 6) at the same meeting (Concession Guidelines, Section 9(2)2.(2)).

Second, the Concession Guidelines provide for the transfer of a Concession Right. While the PFI Act requires the resolution of a local assembly approving the transfer of the Concession Right (PFI Act, Article 26, paragraph 4), the Concession Guidelines clarify that the local assembly may, by local ordinance, remove that requirement (Concession Guidelines, Section 9(2)2.(5)). But this “bypass” does not directly apply to the requirement under the Local Government Act for a local assembly resolution to rescind the appointment of the current Concessionaire (transferor) and to appoint the new Concessionaire (transferee) as Designated Public Facility Manager when a Concession Right is transferred. Thus, it is theoretically possible for a local assembly to prevent the new Concessionaire from operating the public facility by not passing the resolution required by the Local Government Act appointing it as the new Designated Public Facility Manager. In this regard, the Concession Guidelines make a very subtle statement that the rescission and granting of appointment as Designated Public Facility Manager “should in practice be handled together with the discussions pertaining to the transfer of the Concession Right, so that any discrepancy (i.e., a situation in which the transfer of the Concession Right is permitted under the PFI Act, but the local assembly rejects the appointment of the new Concessionaire as the new Designated Public Facility Manager under the Local Government Act) is not likely to arise” (Concession Guidelines, Section 9(2)2.(5)). But, even with the guidelines in place, there is still concern

STRUCTURED FINANCE / BANKING BULLETIN

that political circumstances surrounding the local assembly at the time a transfer of a Concession Right is to take place may affect the required local assembly vote.

Third, the Concession Guidelines provide guidance on the setting of fees to be charged to users, and on the rescissions of both the Concession Right and the appointment of a Designated Public Facility Manager, under the dual regulatory frameworks.

5. Maintenance, Renovation, Replacement and Construction of the Facilities

If it becomes necessary to repair or rehabilitate public facilities which are the subject of a Concession Right or to construct new facilities during the concession period, the scope of the Concessionaire's rights (i.e., the measures that the Concessionaire is permitted to take) may be an issue.

On this point, it should be noted that "construction" and "renovation" (see PFI Act, Article 2, paragraph 2) of public facilities are outside the scope of the "Operation of Public Facilities" defined under the PFI Act, that is, the subject matter of the Concession Right. On the other hand, "maintenance" of public facilities is included in the "Operation of Public Facilities" (see PFI Act, Article 2, paragraph 6). The Concession Guidelines clarify which works constitute "construction/renovation" and "maintenance", respectively (see, Concession Guidelines, Section (11(1)2)).

Table 2: "Construction," "Renovation" and "Maintenance" under the PFI Act and Scope of Operation of a Concessionaire

Term under the PFI Act	Subject Work	Whether a Concessionaire is permitted to implement
"Construction" and "Renovation"	<ul style="list-style-type: none"> ● Construction of new facilities ● Complete removal and redevelopment of facilities ● Expansion or renovation that requires a change in the registered matters of the Concession Right (e.g., changing the address of a facility because of a change in the location of the facility or an extensive expansion of the area size of the facility) 	No (not permitted)

STRUCTURED FINANCE / BANKING BULLETIN

“Maintenance”	<ul style="list-style-type: none"> Any expansion, renovation, or repair of existing facilities (including large-scale repairs) other than those set out above¹⁷ 	Yes (permitted)
---------------	---	-----------------

Under the Concession Guidelines, generally speaking, a Concessionaire may make expansions or renovations that are necessary to continue the operation of the facilities (Concession Guidelines, Section 11(1)2-3.(1)), but the specific range of such permissible expansions or renovations in a specific project must be determined by the relevant Public Authority, who should consider how the responsibility for the maintenance of the facilities can best be allocated between the Concessionaire and that Public Authority (Concession Guidelines, Section 11(1)2-3.(2)).¹⁸

On the other hand, the construction of new facilities and the complete removal and redevelopment of existing facilities, which are outside the scope of the Concession Right, are to be separately conducted by way of traditional public works or conventional PFI projects (for example, Build-Transfer-Operate (**BTO**) with availability payments). Further, while the existing Concession Right does not cover a newly constructed or redeveloped facility, if the operation of such facilities is delegated to private sectors by way of a PFI Act Concession, the procedures to create a new Concession Right must be undertaken (Concession Guidelines, Section 11(1)2-2.(4)(i)).

6. Assignment and Transfer of Concession Rights

The transfer of a Concession Right, including one following a foreclosure sale, requires the permission of the relevant Public Authority (PFI Act, Article 26, paragraph 2). The Concession Guidelines suggest that if (i) the transferee is not subject to any ground for disqualification and (ii) the transfer of the Concession Right is appropriate in light of the Implementation Policy,¹⁹ the Public Authority

¹⁷ The Concession Guidelines state that “capital expenditure and repairs (including any expansion or large-scale repairs) other than the construction of new facilities and complete removal and redevelopment of facilities” constitute “maintenance”, which is within the scope of the Concession Right.

¹⁸ The Concession Guidelines provide that it is desirable that the Implementation Policy and the project agreement clearly stipulate the details of improvements expected to be made by a Concessionaire and the necessary procedures in relation to the Public Authority including prior or *ex post facto* consent of or notification to the Public Authority (if any). (see Concession Guidelines, Section 11(1)2-3.(3)(iii)(iv))

¹⁹ The “Implementation Policy” is a document published by the relevant Public Authority at the beginning of the bid procedure for a specific PFI project and covers the purpose, scope and structure of the project and the details of the bid procedure.

STRUCTURED FINANCE / BANKING BULLETIN

does not have any discretion and must permit the transfer (Concession Guidelines, Section 13(1)2.(2)). Any condition that a Public Authority may impose for the transfer of a Concession Right must be provided in the Implementation Policy (Concession Guidelines, Section 13(1)2.(3)).

It can be said that the Concession Guidelines have improved the predictability of granting permissions for the transfer of Concession Rights. However, requirement (ii) above still suggests ambiguity, and the determination of whether or not the proposed transfer is “appropriate” may entail some level of subjectivity of the Public Authority. We would thus need to closely watch how Public Authorities will decide the fulfillment of requirement (ii).

7. Rescission of Concession Rights

A Public Authority may rescind a Concession Right if certain events occur with respect to the Concessionaire or if rescission is necessary to protect public interest (PFI Act, Article 29).

Concessionaires who suffer losses as a result of the rescission of its Concession Right due to public interest will be compensated in accordance with the standards of compensation for business as stipulated in the Standards for Compensation for Land Acquired for Public Use (See PFI Act, Article 30, and Concession Guidelines, Section 14(3)2.(1) et seq.). Further, the Public Authority must refund the portion of the concession fee that corresponds to the remaining project term (Concession Guidelines, Section 14(3)2.(6)).

If there is a mortgage over the Concession Right, in principle, the Public Authority must deposit compensation money for that mortgage, and the mortgagee will be entitled to exercise its rights against that compensation money (PFI Act, Article 30, paragraphs 6 and 7).

V. Response to Diversification of PFI Projects and Use of Large-Scale PFI Projects

In the revisions to the PFI Procurement Process Guidelines and the PFI Contract Guidelines, a provision on the transfer of shares of the project company and a note on allowing corporate forms other than *Kabushiki-Kaisha*

STRUCTURED FINANCE / BANKING BULLETIN

(K.K.) have been added to assist the diversification of PFI projects and to develop large-scale PFI projects.

1. Transfer of Shares of Project Company

In past PFI projects in Japan, consortium members were required to be shareholders of the project company throughout the project term, and in many cases the transfer of shares of the project company without the approval of the Public Authority was prohibited in the basic agreement between the Public Authority and the consortium members as well as the PFI project agreements. However, the revised PFI Contract Guidelines clearly acknowledge that the need to restrict share transfers depends on various factors such as the content and phase of the project and clarify that conditions to the transfer of shares held by a consortium member must be kept to the minimum extent necessary to appropriately implement the project, given the role of each such consortium member in the project (PFI Contract Guidelines, Section 6-2, paragraph 2, and see also paragraph 3 of the exhibit on the basic agreement attached to the PFI Contract Guidelines).

For example, in a PFI project for the construction of a facility where the construction company is a consortium member, the PFI project agreement may provide that the construction company may sell its shares in the project company after the lapse of a fixed period after the completion of the construction (PFI Contract Guidelines, Section 6-2, paragraph 2(1)). The PFI Contract Guidelines also allow the more relaxed transfer mechanism, in which a consortium member may transfer its shares, subject only to an *ex post facto* notification to the Public Authority, as long as the transferee is not in a pre-established blacklist (PFI Contract Guidelines, Section 6-2, paragraph 2(2), and Paragraph 4 of the exhibit on the basic agreement attached to the PFI Contract Guidelines).

In projects where the shares of a project company may be acquired by a warrant holder exercising an option or a lender exercising step-in rights, the requirements for a typical share transfer as mentioned above must be satisfied (PFI Contract Guidelines, Section 6-2, paragraph 2(2)).

STRUCTURED FINANCE / BANKING BULLETIN

2. Corporate Forms of Project Companies

Stock Companies (*Kabushiki-Kaisha*) are widely used as the corporate form of project companies in PFI projects. However, the PFI Procurement Process Guidelines clarified that other corporate forms may be used (PFI Procurement Process Guidelines, Section 4-1(10)), as long as (i) applicable laws and regulations allow the chosen form to conduct the contemplated business and (ii) there is assurance that the project company is able to implement the project throughout the project period (PFI Procurement Process Guidelines, Section 4-1(10)).

VI. Improving the Procurement Process

The PFI Procurement Process Guidelines were revised to utilize the private sector's skills and give the private sector more incentives to be involved in PFI projects.

1. Utilizing Private Sector Proposals

To promote the utilization of skills and innovation of the private sector, the 2011 Revised PFI Act introduced the Private Proposal System (PFI Act, Article 6), and the revised PFI Basic Policy issued in 2011 provided guidance on how Public Authorities should deal with private sector proposals. Further, for the same reasons, the PFI Procurement Process Guidelines were revised to provide for (i) the promotion of disclosure by Public Authorities of information required for the private sector to make proposals, (ii) the protection of intellectual property included in the private sector's proposal, and (iii) extra weighting in favor of proposing entities in bid processes (PFI Procurement Process Guidelines, Sections 1-2 and 4-1(13)).

2. Utilizing Private Sector Innovation

The revisions to the PFI Procurement Process Guidelines also added provisions on bidding in order to utilize innovation in the private sector. Specifically, it is worthy to note that the revised PFI Procurement Process Guidelines (i) emphasize that "negotiated contracts" such as "competitive proposals" may be used when necessary to seek a wide range of proposals from a multifaceted perspective when it is difficult for the Public Authority to set

STRUCTURED FINANCE / BANKING BULLETIN

service requirements for itself, and when so allowed under Article 29-3, paragraph 4 of the Public Accounting Act (PFI Procurement Process Guidelines, Section 4-1(11)(i)-1), and (ii) added provisions regarding “competitive dialogue” (PFI Procurement Process Guidelines, Section 4-1(11)(i)-2).

Provisions were also added regarding the utilization of the Technological Proposal System (PFI Act, Article 10, and PFI Procurement Process Guidelines, Section 4-1(11)(ii)-3).

VII. Conclusion

Significant reforms in regulatory frameworks for PPPs in Japan, particularly in using concessions to operate infrastructure facilities, have been put in place in recent years. The government has shown a positive attitude towards PPPs with the hope of reducing its fiscal deficit and stimulating the economy. The introduction of the PFI Act Concession in various infrastructure projects such as airports, roads, and water and sewage systems is being widely discussed. Efforts to enhance investments in infrastructure such as the creation of the PFIPCJ and moves to establish a listed infrastructure market are also being made.²⁰ These recent trends demonstrate encouraging and exciting times for PPPs and PFIs in Japan.

Mori Hamada & Matsumoto will continue to closely monitor the progress of PPPs and PFIs and the infrastructure market in Japan and report to you substantial and significant developments.

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

²⁰ Tokyo Stock Exchange, Study Group on the Listed Infrastructure Market, “Report by the Study Group on the Listed Infrastructure Market – Toward Establishing the Listed Infrastructure Market in Japan” (May 14, 2013). See also Mori Hamada & Matsumoto, “Overview of Report by the Study Group on the Listed Infrastructure Market,” *Structured Finance/Capital Market/Asset Management Bulletin May 2013* (in Japanese). An English version will be published soon.