

---

# THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW

---

EDITORS

BRUNO WERNECK AND MÁRIO SAADI

LAW BUSINESS RESEARCH

# THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW

---

The Public-Private Partnership Law Review  
Reproduced with permission from Law Business Research Ltd.

This article was first published in The Public-Private Partnership Law Review - Edition 1  
(published in March 2015 – editors Bruno Werneck and Mário Saadi).

For further information please email  
[Nick.Barette@lbresearch.com](mailto:Nick.Barette@lbresearch.com)

# THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW

---

Editors

BRUNO WERNECK AND MÁRIO SAADI

LAW BUSINESS RESEARCH LTD

PUBLISHER  
Gideon Robertson

BUSINESS DEVELOPMENT MANAGER  
Nick Barette

SENIOR ACCOUNT MANAGERS  
Katherine Jablonowska, Thomas Lee

ACCOUNT MANAGER  
Felicity Bown

PUBLISHING COORDINATOR  
Lucy Brewer

MARKETING ASSISTANT  
Dominique Destrée

EDITORIAL COORDINATOR  
Shani Bans

HEAD OF PRODUCTION  
Adam Myers

PRODUCTION EDITOR  
Timothy Beaver

SUBEDITOR  
Janina Godowska

MANAGING DIRECTOR  
Richard Davey

Published in the United Kingdom  
by Law Business Research Ltd, London  
87 Lancaster Road, London, W11 1QQ, UK  
© 2015 Law Business Research Ltd  
[www.TheLawReviews.co.uk](http://www.TheLawReviews.co.uk)

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients.

Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of March 2015, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – [gideon.roberton@lbresearch.com](mailto:gideon.roberton@lbresearch.com)

ISBN 978-1-909830-33-2

Printed in Great Britain by  
Encompass Print Solutions, Derbyshire  
Tel: 0844 2480 112

# THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND  
TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND  
INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

THE ENERGY REGULATION AND MARKETS REVIEW

THE INTELLECTUAL PROPERTY REVIEW

THE ASSET MANAGEMENT REVIEW

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

THE CARTELS AND LENIENCY REVIEW

THE TAX DISPUTES AND LITIGATION REVIEW

THE LIFE SCIENCES LAW REVIEW

THE INSURANCE AND REINSURANCE LAW REVIEW

THE GOVERNMENT PROCUREMENT REVIEW

THE DOMINANCE AND MONOPOLIES REVIEW

THE AVIATION LAW REVIEW

THE FOREIGN INVESTMENT REGULATION REVIEW

THE ASSET TRACING AND RECOVERY REVIEW

THE INTERNATIONAL INSOLVENCY REVIEW

THE OIL AND GAS LAW REVIEW

THE FRANCHISE LAW REVIEW

THE PRODUCT REGULATION AND LIABILITY REVIEW

THE SHIPPING LAW REVIEW

THE ACQUISITION AND LEVERAGED FINANCE REVIEW

THE PRIVACY, DATA PROTECTION AND CYBERSECURITY LAW REVIEW

THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW

# ACKNOWLEDGEMENTS

---

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ALLENS

FASKEN MARTINEAU DUMOULIN LLP

HERBERT SMITH FREEHILLS LLP

JUN HE LAW OFFICES

KILPATRICK TOWNSEND & STOCKTON LLP

LIEDEKERKE

M & M BOMCHIL

MAPLES AND CALDER

MATTOS FILHO, VEIGA FILHO, MARREY JR E QUIROGA  
ADVOGADOS

MORI HAMADA & MATSUMOTO

PAKSOY

PARQUET & ASOCIADOS

SYCIP SALAZAR HERNANDEZ & GATMAITAN

TPLA

WHITE & CASE

# CONTENTS

---

<b>Editors' Preface</b>	.....v
	<i>Bruno Werneck and Mário Saadi</i>
<b>Chapter 1</b>	ARGENTINA.....1
	<i>María Inés Corrá and Leopoldo Silva Rossi</i>
<b>Chapter 2</b>	AUSTRALIA.....10
	<i>David Donnelly, Nicholas Ng and Barton Donaldson</i>
<b>Chapter 3</b>	BELGIUM.....20
	<i>Christel Van den Eynden, Frank Judo, Aurélien Vandeburie and Marjolein Beynsberger</i>
<b>Chapter 4</b>	BRAZIL.....34
	<i>Bruno Werneck and Mário Saadi</i>
<b>Chapter 5</b>	CANADA.....44
	<i>Nicholas Shkordoff, Helmut K Johannsen and W Thomas Barlow</i>
<b>Chapter 6</b>	CHINA.....58
	<i>Jianan Yuan and Yu Qin</i>
<b>Chapter 7</b>	FRANCE.....74
	<i>François-Guilhem Vaissier, Hugues Martin-Sisteron and Anna Seniuta</i>
<b>Chapter 8</b>	IRELAND.....91
	<i>Mary Dunne</i>
<b>Chapter 9</b>	JAPAN.....99
	<i>Masanori Sato, Shigeki Okatani and Yusuke Suehiro</i>



<b>Chapter 10</b>	MOZAMBIQUE ..... 114 <i>Taciana Peão Lopes</i>
<b>Chapter 11</b>	PARAGUAY ..... 121 <i>Javier Maria Parquet Villagra and Karin Basiliki Ioannidis Eder</i>
<b>Chapter 12</b>	PHILIPPINES ..... 132 <i>Marivic G Ramos-Añonuevo and Arlene M Maneja</i>
<b>Chapter 13</b>	TURKEY ..... 143 <i>Zeynel Tunç, Nilüfer Türkçü and Aslı Kehale Altunyuva</i>
<b>Chapter 14</b>	UNITED KINGDOM ..... 154 <i>Adrian Clough, Paul Butcher and Anand Gangadia</i>
<b>Chapter 15</b>	UNITED STATES ..... 170 <i>Robert H Edwards, Jr, Randall F Hafer and Mark J Riedy</i>
<b>Appendix 1</b>	ABOUT THE AUTHORS ..... 189
<b>Appendix 2</b>	CONTRIBUTING LAW FIRMS' CONTACT DETAILS ... 203

## EDITORS' PREFACE

---

We are very pleased to present this first edition of *The Public-Private Partnership Law Review*. Despite the existence of articles in various law reviews on topics involving public-private partnerships (PPPs) and private finance initiatives (in areas such as projects and construction, real estate, mergers, transfers of concessionaires' corporate control, special purpose vehicles and government procurement, to name but a few), there is a need for a deeper understanding of how different countries address specific matters on this topic. This book is an initial effort to fulfil this need.

In 2014, Brazil marked the 10th year since the publication of its Public-Private Partnership Law (Federal Law No. 11,079/2014). Our experience with this law is still very recent, especially in comparison with other countries where discussions on PPP models and the need to attract private investment into large projects dates back to the 1980s and '90s.

In view of that, we hope a comparative study covering practical aspects and different perspectives on public-private partnership issues will become an important tool for the strengthening of the model worldwide. We are certain this study will bring about a better dissemination of best practices implemented by private professionals and government authorities working on PPP projects around the globe.

Our contributors have been drawn from the most renowned firms working in the PPP field in their jurisdictions and we would like to thank all of them for their support in producing this first edition of *The Public-Private Partnership Law Review*.

We strongly believe that PPPs are an important tool for generating investments (and development) and creating efficiency not only in infrastructure, but also in the provision of public services, such as education and health, as well as prisons, monitoring urban areas and public lighting. PPPs are also an important means of combating corruption in the old and inefficient model of direct state procurement of projects.

We hope you enjoy this first edition of *The Public-Private Partnership Law Review* and we sincerely expect that this book will become, in the coming years, a comprehensive international guide to the anatomy of PPPs. We also look forward to hearing your thoughts on this edition and particularly your comments and suggestions for improving future editions of this work.

**Bruno Werneck and Mário Saadi**  
Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados  
São Paulo  
March 2015

## Chapter 9

---

# JAPAN

*Masanori Sato, Shigeki Okatani and Yusuke Suehiro<sup>1</sup>*

### I OVERVIEW

Japan is entering a new era for public-private partnerships (PPPs). Public authorities operating under severe fiscal constraints have recognised the importance of, and the role of PPPs in, maintaining and improving existing infrastructure. The national government is intensively promoting economic infrastructure concessions as part of national revitalisation strategies, highlighting airports, water supplies, sewage and roads as priority areas.<sup>2</sup> Against this backdrop, concession projects, including those for several airports, commenced bidding processes in 2014.

### II THE YEAR IN REVIEW

In Japan, the Act on the Promotion of Private Finance Initiatives (the PFI Act), enacted in 1999, governs most PPP projects, referred to as private finance initiatives (PFIs). In 2011, this law was revised to allow the use of concessions and expand ‘user pays’ projects in which the national or a local governmental authority (as applicable, the ‘relevant authority’) grants to a private entity (the concessionaire) the right to operate existing infrastructure and earn income by charging user fees, in contrast to most PFIs in Japan, which are structured under the traditional PFI model in which project companies receive availability payments from the relevant authorities. Subsequently, the national government issued several guidelines providing detailed guidance on practical matters and interpretation of affected laws.

---

1 Masanori Sato is a partner and Shigeki Okatani and Yusuke Suehiro are senior associates at Mori Hamada & Matsumoto.

2 Revision of ‘Japanese Revitalisation Strategy – Japan is Back’, dated 14 June 2014 (published by the government of Japan), pp. 65–66 and 72–74.

Airport concessions lead this new area of law and business, largely enhanced by new legislation, which has made it easier to privatise airports owned and operated by the national or local governments. In 2014, the Sendai Airport and the Kansai-Osaka (Itami) International Airport projects initiated bidding processes that drew huge public attention.

Water supplies and sewage concessions are expected to follow suit. In March 2014, Japan's Ministry of Land, Infrastructure, Transport and Tourism released the Draft Sewage Concession Guidelines to support local governments regarding sewage concessions. Osaka City issued its Draft Basic Policy to privatise its water services through concessions. Hamamatsu City has been working continuously on feasibility studies on water supplies and sewage concessions, including the sewage system in the Saiein area, which it will receive from Shizuoka Prefecture in 2016 after the city annexes that area.

Concessions for toll roads are another important area. Several local governments such as Aichi Prefecture are considering using concessions for toll roads operation. A new legislation necessary to allow private entities to manage toll roads (as discussed below) under concession is expected to be submitted to the Diet this year.

### III GENERAL FRAMEWORK

#### i Types of public-private partnership

##### *Traditional arrangement*

Until the introduction of concessions, more than two-thirds of traditional PFI projects have been undertaken using build–transfer–operate (BTO) arrangements where:

- a* a private entity as the contractor, usually a special purpose company formed by a consortium of project sponsors, constructs a facility (typically, social infrastructure such as governmental buildings and local public facilities);
- b* after completing the work, the contractor transfers the facility to the relevant authority and subsequently operates it for a specified period; and
- c* the contractor earns its revenues through the availability fees that the relevant authority pays in exchange for the construction and services.

While traditional PFIs feature BTO arrangements, the PFI Act permits other structures. For example, the international passenger terminal and the international air cargo terminal at Haneda Airport were constructed in 2010 and are operated under a build–operate–transfer (BOT) arrangement.

Since the PFI Act was enacted in 1999, it has brought in 440 projects totalling more than ¥4.3 trillion as of 31 March 2014.<sup>3</sup> Meanwhile, the national government had considered taking advantage of more private sector funds and expertise for PFIs by giving the private sector a wide range of rights (including the right to determine user fees) along with risks and responsibilities.<sup>4</sup> The government has also emphasised the importance

---

3 See the Cabinet Office website: [www8.cao.go.jp/pfi/pfi\\_gaiyou.html](http://www8.cao.go.jp/pfi/pfi_gaiyou.html).

4 Yasuyuki Kurano and Masatomo Miyazawa, *Kaisei PFI Hono Gaiyou (3 kai)* ('Overview of the Revised PFI Act (III)'), Kinyu Homu Jijo, Vol. 1927, pp.122–126.

of ‘user pays’ projects in developing the Japanese PFI market and attracting financiers, resulting in the birth of the concession framework.<sup>5</sup>

### *Concessions*

In a concession project:

- a* the relevant authority administering an existing facility grants a concessionaire the right to maintain and operate the facility for a specified period (the concession right);<sup>6</sup>
- b* the relevant authority continues to own the facility. The concessionaire may determine and collect user fees or tolls as its own income;<sup>7</sup>
- c* the relevant authority may charge the concessionaire concession fees for the concession right. The concession fees, which are usually calculated through the discontinued cash flow method but ultimately decided through bidding processes, are paid up front or in instalments depending on the concession agreement.

The first project using this framework is the National Women’s Education Centre of Japan comprising accommodation and training facilities. The project was announced in February 2014 and the request for proposals was issued in August. The concessionaire will start operating in April 2015.

### **ii The authorities**

All PFI projects are governed by the PFI Act but are procured by the national government, local governments or government-related organisations.<sup>8</sup> Generally, a project would be overseen by a particular division within the relevant authority responsible for the target facility.

PFI is promoted by the PFI Promotion Office within the national government’s Cabinet Office. The PFI Promotion Office has issued its basic policy and the following guidelines regarding practical aspects of PFIs:

- a* the Procurement Process Guidelines;
- b* the Value-for-money (VFM) Guidelines;
- c* the Risk Allocation Guidelines;
- d* the Contract Guidelines;
- e* the Monitoring Guidelines; and
- f* the Concession Guidelines.

The PFI Promotion Office has also standardised the project agreements for traditional BTO projects for social infrastructure and released the ‘Model Project Agreement’ on its website. These guidelines and the Model Project Agreement, which parties are not legally obliged to use, significantly affect PFI practice.

---

5 Id.

6 PFI Act, Article 2, Paragraphs 6 and 7.

7 Id., Article 23.

8 Id., Article 2, Paragraph 3.

Other divisions in the national government as well as some local governments have also developed their own PFI policies and guidelines to utilise PFIs for specific areas such as water supply and sewage infrastructure.

### iii General requirements for PFI contracts

#### *Class of facilities*

PFIs are available for the construction, management and operation of public facilities and infrastructure listed in the PFI Act,<sup>9</sup> such as:

- a* roads, railways, ports, airports, rivers, parks, water supplies, sewage systems and other public infrastructure;
- b* government buildings, housing for government workers and other official facilities;
- c* public housing, social facilities such as educational and cultural facilities, hospitals, social welfare facilities, prisons and other social infrastructure;
- d* information and communications facilities, heat supply facilities, new energy facilities, recycling facilities (excluding waste treatment facilities), tourist facilities, and research facilities; and
- e* vessels, aircraft and other transportation vehicles, and satellites (including the facilities required to operate these vehicles).

Some public laws, however, restrict the ability of the private sector to manage and operate specific classes of public facilities, including airports and roads.<sup>10</sup> Since the PFI Act does not *per se* override these laws, further legislation is required to enable concessionaires to undertake the management or operation of those 'restricted' public facilities. Since the introduction of concessions in 2011, the government has enacted special laws enabling concessions, or has expressed its administrative interpretation of the relevant public laws to the effect that those laws do not hinder concessions, for major infrastructure, including airports, water supplies and sewage systems. Today, roads are the last major infrastructure subject to such restrictions. However, the government is preparing to submit a bill to apply the Act on Special Zones for Structural Reform to specifically enable Aichi Prefecture to grant concessions for eight toll road routes.

#### *Scope of concession rights*

Concession rights are subject to certain limitations. Generally, a concessionaire may make expansions or renovations that are necessary to operate the facilities<sup>11</sup> though the exact scope of permissible expansions or renovations in a project needs to be clarified by the relevant authority. In contrast, the construction of new facilities and the complete removal and redevelopment of existing facilities are clearly outside the scope of concessions.<sup>12</sup> Nevertheless, it does not mean that the PFI Act prevents greenfield projects from using

---

9 Id., Article 2, paragraphs 1 and 2.

10 Basic Policy for the Implementation of PFI Projects, Chapter 4, Section 1(3).

11 Concession Guidelines, Section 11.

12 Id.

concessions, which may be done through the combination of traditional arrangements (for the construction phase) and concessions (for the operation phase).

### *VFM analysis*

If a potential project falls within the scope of permitted facilities and services, the relevant authority must conduct a VFM analysis to confirm whether the project is appropriate for PFIs and whether it may go ahead.<sup>13</sup> This analysis may be a burden for the relevant authority but recent revisions to the applicable guidelines suggest a shorter process for traditional projects, such as construction of governmental buildings, by using precedents.<sup>14</sup>

### *Term*

Projects under traditional arrangements usually have contract terms of between 15 and 30 years. Traditional PFIs with the national government are limited to 30 years due to the Public Finance Act limit on the terms of contracts under which the national government is obliged to pay for more than one fiscal year.<sup>15</sup> PFIs with local governments and government related organisations do not have term limits. In addition, some laws restrict the period during which a private entity may use assets owned by a relevant authority. In most cases of land with a building on it, the maximum period of use is 30 years.<sup>16</sup>

There are no restrictions on concession terms, and the PFI Act does not mandate a maximum concession term. Accordingly, a relevant authority may decide the term on a project-specific basis.<sup>17</sup> For example, airport concessions have terms of between 30 to 50 years.<sup>18</sup> In addition, a concession term may be extended, subject to the conditions in the concession agreement.<sup>19</sup>

## **IV BIDDING AND AWARD PROCEDURE**

The general process for procuring PFI projects, whether using traditional arrangements or concessions, is as follows:<sup>20</sup>

- a* the relevant authority draws up an implementation policy, which outlines the project and the bidding process;<sup>21</sup>

---

13 VFM Guidelines.

14 Revision of the Procurement Process Guidelines and the VFM Guidelines.

15 Strictly speaking, the Public Finance Act provides five years but the PFI Act extended the term to 30 years (PFI Act, Article 68).

16 National Property Act, Article 21, Paragraph 1, Item (iii).

17 Concession Guidelines, Section 15(2)2.(1).

18 Minister of Land, Infrastructure, Transport and Tourism, 'Basic Policy for Airport Concession of National Airports', 2013 (Basic policy for Airport Concessions), Section 2.

19 Id.

20 Procurement Process Guidelines.

21 PFI Act, Article 5.

- b* it conducts a VFM analysis and identifies the project scope;<sup>22</sup> and
- c* finally, it conducts a bidding process and awards the project to the selected project sponsor.

The Procurement Process Guidelines provide the general guidance for the bidding process to ensure the transparency, fairness and competitiveness of the process.

The Agreement on Government Procurement (GPA) under the WTO framework applies to certain types of PFI projects above certain thresholds procured by the national government, prefectures, certain major cities and certain government-affiliated organisations. For example, the GPA applies to PFI projects whose main purpose is construction service worth ¥580 million (4.5 million SDR) or more procured by national government agencies or ¥1.94 billion (15 million SDR) or more by local governments. However, concessions in Japan are currently exempted from the application of the GPA.

### **i Expressions of interest**

Under the Procurement Process Guidelines, Authorities are encouraged to invite and assess expressions of interest, proposals and requests for information from the private sector.<sup>23</sup> These proposals may influence the implementation policy as the pertinent relevant authority identifies the project scope and initiates the bidding process. With respect to the Sendai Airport project, for example, the government first released the draft of the concession scheme in November 2013, and later conducted a market sounding and invited public comments. The implementation policy issued in April 2014 showed changes from the draft, which implies that the government had considered the private sector's comments.

### **ii Requests for proposals and unsolicited proposals**

#### *Requests for proposals*

Generally, a project sponsor is selected through a competitive procedure. Following the VFM analysis and the decision to initiate a project, the relevant authority starts the bidding process by issuing a request for proposals and a tender package (including the requirements for services and specifications, the criteria for awarding the project, and the drafts of the project agreement and other relevant contracts). Although bidders may be required to post deposits to ensure that they honour the bids, deposits have been exempted in many past projects.<sup>24</sup>

#### *Unsolicited proposals*

In 2011, the revised PFI Act introduced the unsolicited proposal system through which the private sector may propose a PFI project.<sup>25</sup> Competitive bidding is still required even

---

22 Id., Article 7.

23 Procurement Process Guidelines, Section 1-2.

24 See the PFI Promotion Office website: [www8.cao.go.jp/pfi/tebiki/jitsumu/jitsumu04.html](http://www8.cao.go.jp/pfi/tebiki/jitsumu/jitsumu04.html), (question 4.7).

25 PFI Act, Article 6.



if the unsolicited proposal induces the relevant authority to start a PFI procedure. Thus, the proponent must participate in the bidding process, although the relevant authority is required to protect the proponent's intellectual property that is contained in the proposal.<sup>26</sup> The revised Procurement Process Guidelines allow the relevant authority, in the bidding process, to consider in the favour of the proponent bidder, how its proposal contributes to the project with attention to fairness, transparency and competitiveness.<sup>27</sup>

### iii Evaluation and grant

#### *Qualification*

A relevant authority sets qualifications for bidders in the request for proposal. A bidder may be either a single corporation or a consortium (which is typical in most major projects). The relevant authority also sets qualifications for the consortium or for each member of the consortium, or for both.

A relevant authority may adopt a pre-qualification process or multi-phase selection process if a sizeable number of bidders are expected to participate.<sup>28</sup> In a typical competitive dialogue procedure (see 'Bidding process', *infra*), before the competitive dialogues start, the bidders are shortlisted to around three based on documentary submissions.<sup>29</sup>

The PFI Act and other laws enumerate the grounds for disqualification.<sup>30</sup> A relevant authority may also set additional qualifications for specific projects. In many past cases, authorities required certain financial capacity and capability for long-term risk management and project management.<sup>31</sup> Although the PFI Act does not restrict foreign sponsors' entry, the relevant authority may set additional qualifications, such as the bidder's experience or knowledge of business in Japan, which some foreign sponsors may find hard to meet. The bidders may also be subject to governmental scrutiny concerning national security, crisis management and contribution to local economy.<sup>32</sup>

#### *Bidding process*

Most PFI projects are procured through either the competitive dialogue procedure or the open and competitive bidding procedure.<sup>33</sup> In the competitive dialogue procedure, which may be adopted if a relevant authority has difficulties setting out the proper service requirements and specifications, the relevant authority may have dialogues concurrently with multiple bidders.<sup>34</sup> Taking the dialogues into account, the relevant authority finalises the service requirements and specifications before the bidders submit their final

---

26 Procurement Process Guidelines, Section 1-2(1).

27 Id. Section 4-1(13)–(16).

28 Id. Section 4-1(11)(i)-2-1 and (ii)-1-2.

29 Id. Section 4-1(11)(i)-2-1.

30 PFI Act, Article 9.

31 PFI Procurement Process Guidelines, Section 4-1(11)(ii)-1-2.

32 Basic policy for Airport Concessions, Section 2-10.

33 PFI Procurement Process Guidelines, Id. Section 4-1(11).

34 Id.

proposals.<sup>35</sup> In contrast, the open and competitive bidding procedure is less flexible because the requirements cannot be modified or revised once the bidding process has begun; however, the relevant authority is allowed to communicate with bidders to clarify the requirements as long as the transparency and fairness of the process are maintained.<sup>36</sup>

### *Awarding contracts*

In determining the winning bidder, the relevant authority takes into consideration not only the bid price but also other factors such as service quality. The weight of each factor is described in the criteria for awarding the project included in the tender package. In general, once the winning bidder is selected, it may not negotiate with the relevant authority to modify the terms and conditions of the project.

The relevant authority and the selected sponsor enter into a basic agreement, which contains the sponsor's obligations regarding preparations for the project. Afterward, the contractor or the concessionaire and the relevant authority execute a project agreement (or a concession agreement for concessions), the main document containing their rights and obligations regarding the project.

## **V THE CONTRACT**

### **i Payment**

#### *Traditional arrangement – availability fees*

In traditional projects, the relevant authority pays availability fees for the services provided by the contractor.<sup>37</sup> The project agreement sets out the calculation mechanism, which is either: (1) unitary charges; or (2) charges made up of separate elements (such as costs of construction, finance, maintenance and operation).<sup>38</sup> Fees may be deducted or withheld if the services do not meet the agreed performance criteria and standards.<sup>39</sup> Payments are typically made on a semi-annual or a quarterly basis.<sup>40</sup>

#### *Concessions – user fees*

In general, the concessionaire determines and charges user fees for the use of the public facilities and collects the fees as its own revenues.<sup>41</sup> The fee determination, however, may be subject to the concession agreement or to applicable laws and regulations on the pertinent infrastructure (e.g., the Airport Act, the Water Supply Act and the Sewage Service Act).

---

35 Id.

36 Id.

37 PFI Contract Guidelines, Section 4.

38 Id., Section 4-3.

39 Id.

40 Id., Section 4-4.

41 PFI Act, Article 23.

**ii State guarantees**

Generally, there is no state guarantee on a relevant authority's payment obligations to either the contractor or the concessionaire.

**iii Distribution of risk**

Several guidelines clarify that proper risk allocation should be accomplished through the principle that the party in the best position to manage a risk bears that risk.<sup>42</sup>

***Force majeure***

In traditional projects, the project agreement typically stipulates that if a force majeure event occurs:

- a* the parties are relieved of their contractual obligations;
- b* the handover date or service commencement date is postponed; and
- c* if the force majeure lasts for a certain period of time, the agreement may, upon consultation between the parties, be terminated by the relevant authority or, if allowed in the agreement, the contractor.<sup>43</sup>

To address financial consequences, typical project agreements require that the contractor purchases insurance that meets certain criteria.<sup>44</sup> In many traditional cases, relevant authorities have agreed to bear a substantial portion of uninsurable costs resulting from force majeure.<sup>45</sup>

Concession agreements would likely adopt more or less similar arrangements though relevant authorities may reserve some discretion to decide the extent of costs resulting from *force majeure* that it would bear.<sup>46</sup> However, the parties may also agree on different approaches. For example, concession agreements may provide for the extension of the concession term to compensate the concessionaire for increased costs or losses arising from *force majeure*.<sup>47</sup>

***Change in laws***

In traditional projects, authorities are required to compensate the contractors for increased costs resulting from a change in specific law or governmental action which applies only to the project or similar projects.<sup>48</sup> In other words, the private sector bears the risk of a change in law that has general effect.<sup>49</sup> The agreement may, upon consultation between the parties, be terminated if a change in specific law makes it impossible to continue

---

42 Risk Allocation Guidelines, Article 1, Section 2.

43 Contract Guidelines, Sections 2-2-9, 3-6, 5-3 and 6-9.

44 Risk Allocation Guidelines, Article 2, Section 6(1)(i)-3.

45 Contract Guidelines, Sections 3-6 and 6-9.

46 Draft of the concession agreement for the NWEC project, Section 61.

47 Draft Concession Agreement for Sendai Airport, Section 48.

48 Model Agreement, Section 45.

49 Contract Guidelines, Section 5-3, Paragraph 5.

the project.<sup>50</sup> The range of the specific laws and governmental actions is determined on a project specific basis. Concession agreements would likely provide for similar arrangements, although increased costs may be addressed by extending the concession term, instead of monetary compensation.<sup>51</sup>

### *Demand risk*

In most traditional projects, the private sector does not bear the demand risk because availability payments from the government remain unchanged irrespective of demand for the provided services.

In concession projects and some BOT projects, concessionaires generally bear the demand risk because the project revenues are generated mainly from user fees rather than availability payments. Nevertheless, some guidelines for specific areas address risk sharing mechanisms. For example, the Draft Sewage Concession Guidelines mention that a minimum revenue guarantee by the relevant authority may be adopted as an option to address such risk.<sup>52</sup>

### *Latent defect of existing facilities*

In concession projects where concessionaires will operate existing government-owned facilities, the parties need to consider the risk allocation for latent defects in those facilities. While authorities do not bear the risk of latent defects in principle, and the private sector should minimise this risk through intensive due diligence, some authorities have come to understand that authorities should, to a certain extent, bear the risk of latent defects that are difficult to discover even through due diligence.<sup>53</sup> In the Kansai-Osaka (Itami) International Airport project, for example, the relevant authority will compensate the concessionaire for losses from latent physical defects discovered in certain facilities within 24 months from the commencement of the project, subject to limitations on the scope of defects and compensation.<sup>54</sup>

## **iv Adjustment and revision**

In traditional projects, availability fees may be adjusted as set out in the project agreement. Typically, adjustment is limited to indexation to deal with inflation, although many project agreements do not even contain such indexation, partly because of the stable prices in Japan since the 1990s.<sup>55</sup>

---

50 Id., Paragraph 2.

51 Draft Concession Agreement for Sendai Airport, Sections 45 and 73.

52 Draft Sewage Concession Guidelines, Section 3.6.4(1).

53 Draft Sewage Concession Guidelines, Section 3.6.4(1) and draft Basic Policy for Toll Road Concessions, Attachment 2.

54 Implementation Policy for the Kansai-Osaka (Itami) International Airport project, Chapter 3, Section 9.

55 Contract Guidelines, Section 4-4.

In concessions where concessionaires may set the user fees, a concessionaire may adjust the user fees at its discretion unless otherwise limited by the concession agreement or by applicable laws or regulations.

v **Ownership of underlying assets**

*Traditional arrangement*

In traditional projects using a BTO arrangement, the relevant authority owns the underlying assets, such as land. On completing the construction of the facility on land leased from the relevant authority, the contractor transfers the ownership of the facility to the relevant authority.<sup>56</sup>

*Concessions*

Likewise, relevant authorities own the underlying facilities in concessions, while a concessionaire is granted concession right in respect of such facilities.

A concessionaire's concession right is assignable subject to the consent of the relevant authority.<sup>57</sup> The PFI Act also allows a concessionaire to mortgage its concession right to its lenders, although the consent of the relevant authority for the assignment of the concession right is necessary when the lenders foreclose the mortgage.<sup>58</sup> To alleviate the lenders' concern on unpredictability in the foreclosure of mortgage over concession rights, the concession guidelines provide that if: (1) the transferee would not have been disqualified as a bidder for the project; and (2) the transfer is appropriate in light of the implementation policy, then the relevant authority must approve the transfer.<sup>59</sup>

The grant, transfer and mortgage of a concession right are registered in a manner similar to real property registration.<sup>60</sup> Concessionaires may take advantage of these features to obtain third-party financing, as also set out below.

For tax accounting purposes, a concession right may be depreciated equally over the concession term.<sup>61</sup>

*Airport projects*

Airport projects may require special arrangements because in many airports in Japan, private or third sector entities own and manage non-aeronautical facilities such as terminal buildings and parking lots, while the national or local governments own and manage the runways and other aeronautical facilities. To integrate aeronautical and non-aeronautical operations, the national government intends to have concessionaires acquire the terminal buildings or shares in entities holding terminal buildings.<sup>62</sup> Under such a scheme, concessionaires will operate the aeronautical facilities as concessionaires and the

---

56 Contract Guidelines, Section 2-4-1.

57 PFI Act, Article 24 and Article 26.

58 Id., Article 25.

59 Concession Guidelines, Section 13(1)2.(2).

60 PFI Act, Article 27.

61 Order for Enforcement of the Corporation Tax Act, Articles 13(viii)(k) and Article 48-2.

62 Basic policy for Airport Concessions, Section 3-2(1).

non-aeronautical facilities as owners, although a single integrated procurement process covers both types of facilities as a package.

## vi Early termination

### *Early termination events*

Traditional project agreements generally provide for several causes for early termination, including default, force majeure and a change in law<sup>63</sup> and for the right of the relevant authority to terminate the agreement at any time.<sup>64</sup> Concession agreements would likely be the same. Although the PFI Act enumerates the termination events for concessions,<sup>65</sup> in practice, the parties would likely agree on termination events similar to those under project agreements used for traditional arrangements and which are broader than those provided in the PFI Act.

### *Consequences of early termination*

In traditional project agreements, the relevant authority agrees to pay the contractor the following costs and losses arising from early termination:

- a (if termination occurs during the construction phase) the purchase price for the part of the building that the contractor has completed at the time of the termination; or
- b (if termination occurs after the completion of the construction) the unpaid construction costs.

In either case, payment will be to the extent that the contractor's services meet the required specifications.<sup>66</sup>

In cases of early termination due to the relevant authority's default or voluntary termination, the compensation covers the contractor's costs and losses, such as financing costs and the availability fees for a certain period.<sup>67</sup> If the agreement is terminated due to force majeure or a change in law, the relevant authority will compensate for a reasonable amount of costs according to the risk allocation under the project agreement.<sup>68</sup>

In many projects, if a project terminates upon the contractor's default, the contractor will pay a penalty and, additionally, actual damages if they exceed the amount of the penalty. The Contract Guidelines suggest that the project agreement may provide for either liquidated damages or penalty.<sup>69</sup>

While concession projects would likely adopt similar approaches, some new mechanisms may be anticipated. For example, in concession agreements where the concessionaire must pay the concession fee up front, the relevant authority would

---

63 PFI Contract Guidelines, Section 5.

64 Id.

65 PFI Act, Article 29.

66 Contract Guidelines, Section 5-4.

67 Id.

68 Id., Section 5-3.

69 Id., Sections 5-4 and 5-5.

agree to refund the portion of the concession fee that corresponds to the remaining concession term.<sup>70</sup>

## VI FINANCE

### i Project finance

Generally, the private sector finances PFI projects through project finance which relies on the cash flow generated from the project.

In past projects, authorities have not allowed project companies to transfer, collateralise or dispose of project assets without their approval.<sup>71</sup> When granting security interests, the relevant authority will enter into a direct agreement with the lenders concerning: (1) the creation of security interests over project assets and some procedural matters related to the enforcement of the security interests; and (2) the lenders' step-in rights which allow them, following the contractor's default, to propose to replace the defaulting contractor with another private entity.<sup>72</sup> Apart from adding the concession right as a collateral, the foregoing basic practice would likely be applied to concession projects.

Given that the contractor (or the concessionaire) is a special purpose company formed by the project sponsor, which is usually a consortium of private companies, lenders usually request the consortium members to pledge their shares in the contractor (or the concessionaire). In past projects, the transfers of those shares, including upon the enforcement of the pledge, require the relevant authority's approval but recent revisions to the guidelines suggest that the relevant authority has more flexibility for such share transfers. For example, the relevant authority may adopt an arrangement in which share transfers are subject only to an *ex post facto* notification rather than an approval, as long as the transferee does not fall within a pre-agreed blacklist.<sup>73</sup>

### ii Efforts to expand the PFI market

In traditional projects, a substantial portion of the financing consists of loans from Japanese banks, and equity investors usually come from members (such as a construction company) of the project sponsor consortium. The Japanese PFI market characteristically lacks financial investors and foreign investors.<sup>74</sup> This is partly because traditional projects relying on the relevant authority's availability fees, which have constituted most of the deals executed in the Japanese PFI market, do not need much equity investment and the government has easily been able to finance its infrastructure projects at very low costs.

However, future PFI projects in Japan will likely rely more on private sector investors, including financial investors and foreign investors for the construction and

---

70 Concession Guidelines, Section 14(3)2(6).

71 Contract Guidelines, Section 6-1.

72 Id., Section 5-1.

73 Id., Section 6-2.

74 Japan External Trade Organisation, 'Public Private Partnerships in Australia and Japan; Facilitating Private Sector Participation', 2010, pp.25–26.

maintenance of infrastructure for two reasons: (1) the government has severe financial problems, and some future PFI projects may require a significant amount of investment by private sector investors; and (2) the ‘user pays’ projects, which the government intends to promote, may involve more subtle risk analysis in relation to demand risks and need to secure investments from new classes of investors who bear such risk. Both the government and the market are trying to create a supportive environment in this regard.

As already mentioned, recent revisions to the guidelines allow more flexibility for the transfer of shares in project companies. The revised 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 a stock transfer by a consortium member must be kept to the minimum extent necessary to appropriately implement the project, in light of the role of each consortium member in the project.<sup>75</sup> Further, the guidelines suggest that relevant authorities allow investors to freely transfer non-voting shares.

In October 2013, the Private Finance Initiative Promotion Corporation of Japan (PFIPCJ), co-sponsored by the government and the private sector, including banks and insurance companies, was established.<sup>76</sup> To encourage investors to provide risk money for infrastructure, the PFIPCJ is supposed to financially support ‘user pays’ projects mainly by subordinated debts, preferred stocks or other mezzanine finance.<sup>77</sup> In February 2014, the PFIPCJ decided to finance the Onagawa seafood processing effluent disposal facility as its first deal.<sup>78</sup>

Another development is the Tokyo Stock Exchange’s release of a report, which proposes the basic framework of the listed infrastructure market<sup>79</sup> and its announcement that it intends to establish the rules for the listed infrastructure market by March 2015.

In 2014, the national government revised the Financial Instruments and Exchange Act to allow investment corporations to invest in concession rights. An investment corporation, usually used in a Japanese REIT, is a tax transparent vehicle that may, to the extent that it meets certain conditions, avail itself of tax deductions for dividends paid. As a vehicle investing in real property, it has gained broad acceptance among individual and institutional investors. In this regard, the use of investment corporations is expected to attract institutional investments in public infrastructure, although current tax requirements limit an investment corporation’s investments in concession rights to less than a half of its total assets.

---

75 Contract Guidelines, Section 6-2.

76 PFI Act, Chapter 5.

77 Id., Article 53.

78 See the PFIPCJ’s press release issued on 21 February 2014, [www.pfipcj.co.jp/common/dl/20140221.pdf](http://www.pfipcj.co.jp/common/dl/20140221.pdf).

79 See the Tokyo Stock Exchange press release issued on 14 May 2013, [www.tse.or.jp/english/news/08/130514\\_a.html](http://www.tse.or.jp/english/news/08/130514_a.html).



## **VII OUTLOOK**

The government has opened the way for a new stage of Japanese PFI/PPP by introducing concessions. As some governmental authorities contemplate the advantages of using concessions for various types of public infrastructure, several specific projects have already undergone the procurement process and will commence operations shortly. Further, recent developments in legal, regulatory and practical frameworks will expand the PFI/PPP market in Japan and attract a broad range of investors, whether inside or outside Japan. These developments in Japanese PFI/PPP will warrant special attention in the coming years.

## Appendix 1

---

# ABOUT THE AUTHORS

### **MASANORI SATO**

*Mori Hamada & Matsumoto*

Masanori Sato is the head of MHM's banking and structured financing practice group. He advises across the board on international and domestic structured finance transactions, including PFIs, project finance, REITs and syndicated loans. He has led MHM teams on a number of high-profile transactions, including the first Japanese publicly offered CMBS transaction, the securitisation of public loans originated by the Japanese government and whole business securitisations in a number of sectors. Masanori Sato was educated at the University of Tokyo and the University of Chicago Law School.

### **SHIGEKI OKATANI**

*Mori Hamada & Matsumoto*

Shigeki Okatani has expertise in public-private partnerships, particularly airport and water concessions, renewable energy projects, real estate law, financial regulations and trust law. He has advised domestic and foreign investors and banks on renewable energy projects and sponsors, operators, financial advisers and banks in PPP projects. He is a core member of the firm's infrastructure and energy practice group. Shigeki Okatani was educated at the University of Tokyo and Virginia University Law School, and was previously seconded to the Ministry of Economy, Trade and Industry of Japan.

### **YUSUKE SUEHIRO**

*Mori Hamada & Matsumoto*

Yusuke Suehiro is a senior associate active in the finance practice group of Mori Hamada & Matsumoto. He is also a core member of the firm's infrastructure and energy practice group. He focuses on PPPs/PFIs, project finance, leveraged finance, securitisation and other bespoke structured finance transactions. He has advised a wide range of borrowers

and issuers, as well as major banks and securities companies as lenders or arrangers in both domestic and cross-border transactions. Yusuke Suehiro was educated at the University of Tokyo and the University of Chicago Law School.

**MORI HAMADA & MATSUMOTO**

Marunouchi Park Building

2-6-1 Marunouchi

Chiyoda-ku

Tokyo 100-8222

Japan

Tel: +81 3 6212 8330

Fax: +81 3 6212 8230

masanori.sato@mhmjapan.com

shigeki.okatani@mhmjapan.com

yusuke.suehiro@mhmjapan.com

www.mhmjapan.com