ICLG

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1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have contracts which place both design and construction obligations upon contractors? If so, please describe the types of contract. Please also describe any forms of design-only contract common in your jurisdiction. Do you have any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to "construction contracts" as an abbreviation for construction and engineering contracts.)

For private construction works, a group of four professional associations of architects and contractors jointly published the "General Conditions for Construction Contract (amended in 2011)" (the "GCCC"). For public construction works, the central government published the "Public Work Standard Contract" (amended in 2010) (the "PWSC"). For industrial plant construction works, the "ENAA General Conditions for Domestic Plant Construction Work" (amended in 2011) (the "ENAA-Domestic"), an EPC turnkey contract, is published by the Engineering Advancement Association.

For private contracts of design and build works, the Japan Federation of Construction Contractors published the "General Conditions for Design/Build Contract" (published in 2012) (the "GCDB"). For design works and supervising services of construction works, the above-mentioned group of four associations also published "General Conditions for Design Work and Supervision" (amended in 2013) (the "GCDS").

1.2 Are there either any legally essential qualities needed to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations), or any specific requirements which need to be included in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

In principle, a contract is validly formed by an offer and a corresponding acceptance. In addition, the Construction Business Act (Act No. 199 of 1949, as amended) (the "CBA") requests that a construction contract shall made "in writing," stipulating at least 14 items provided in the CBA (Art 19), to make contract terms clear and unequivocal (see question 1.5). A simple violation of the CBA does not make a contract invalid because the CBA is only an administrative regulation. One exception is an arbitration agreement, which shall be made in writing; an oral arbitration agreement is invalid (Art 13, Para 2 of the Arbitration Act (Act No. 138 of 2003, as amended)).

1.3 In your jurisdiction please identify whether there is a concept of what is known as a "letter of intent", in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

A letter of intent is often used in certain types of transactions, such as M&A, joint ventures and business alliances. A letter of intent can be a binding document if it is so drafted. In construction contracts, letters of intent are rarely used.

1.4 Are there any statutory or standard types of insurance which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors all risk insurance?

No, there is no standard type of insurance required by statute, except mandatory workers' accident compensation liability insurance. In practice, the GCCC/GCDB/ENNA requests a contractor to purchase and maintain insurance to cover an executed portion of work, materials, building equipment and other items. Contractors usually purchase all risk insurance.

1.5 Are there any statutory requirements in relation to construction contracts in terms of: (a) general requirements; (b) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (c) tax (payment of income tax of employees); or (d) health and safety?

As general requirements, the CBA (Art 19) provides 14 items to be stipulated in the contract, including (i) scope of work, (ii) contract price, (iii) commencement and completion date, (iv) advance payment, (v) variation, (vi) *force majeure*, (vii) price adjustment, (viii) damages to third parties, (ix) use of materials and equipment, (x) inspection and hand-over, (xi) terms of payment, (xii) defect liability, (xiii) delay and damages, and (xiv) dispute resolution. Labour, tax and health and safety are not legally required items in the construction contract.

1.6 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability is complete?

For main construction contracts between the employer and the main contractor, there is no regulation applicable to retention. For sub-contracts, the employer has to pay a full amount to the contractor within a certain period of time under the CBA (Art 24-3 and 24-5), once the work is substantially completed and is handed over to the employer.

1.7 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee performance, and/or company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such bonds and guarantees?

In the PWSC, the contractor is required to submit a kind of performance guarantee and it may choose to obtain and submit a performance bond issued by a bank or insurance company (Art 4, PWSC). On the other hand, in private contracts, it is not common to request the contractor to submit a performance bond, although it is possible for the employer to request a guarantee of the contractor's parent company.

1.8 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that until they have been paid they retain title and the right to remove goods and materials supplied from the site?

Theoretically, it is possible for the parties to agree that the contractor shall retain titles to goods and supplies used in the works, unless they are indivisibly attached to an uncompleted part of the work. In practice, titles to goods and materials which are already used in and become parts of an uncompleted work shall be taken by the employer, and the contractors shall be entitled to be paid up their value, if the contract is terminated (Art 33, GCCC).

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be suspended on behalf of the employer by a third party? Does any such third party (e.g. an engineer or architect) have a duty to act impartially between contractor and employer? Is that duty absolute or is it only one which exists in certain situations? If so, please identify when the architect/engineer must act impartially.

No, it is not common to give a third party power to suspend the work. The employer may designate a third party to be a supervisor for the works. Such supervisors usually act on behalf of the employer and they are not requested to be impartial.

2.2 Are employers entitled to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

Theoretically, it is possible for the parties to agree that the employer shall pay a price to the contractor when the employer is paid by an investor, fundraiser, and the like. Important exceptions are sub-contracts: for example, general main contractors (*tokutei-kensetsu-gyosha*) have to make a payment within 50 days from the hand-over date (Art 24-3 and 24-4, CBA).

2.3 Are the parties permitted to agree in advance a fixed sum (known as liquidated damages) which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss suffered?

Liquidated damages are valid and enforceable. Courts cannot change an amount agreed by the parties (Para 1, Art 420, Civil Code (Act No. 89 of 1896)), but a contractor can claim a reduction of the amount if an employer is comparatively negligent (Sup Ct, Judgment of 21 Apr 1994, 172 Minshu 379). Furthermore, it is commonly understood that a contractor shall be discharged if a delay is not attributable to the contractor.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be done under the contract? Is there any limit on that right?

The laws are silent on variation and limit to the variation. In practice, most of the contract forms entitle the employer to a right to vary the works (Art 28, GCCC; Art 40, GCDC; Art 28, ENAA). The PWSC provides that the employer is entitled to change "design documents" which may lead to a variation of works (Art 19, PWSC). The GCCC and GCDS allow the variation "when necessary", while the ENAA permits it as long as it is "reasonable".

3.2 Can work be omitted from the contract? If it is omitted, can the employer do it himself or get a third party to do it?

The laws and regulations, as well as most contract forms, are silent on omission. Omission may be allowed on the same basis as variations, since, for example, the GCCC provides that the amount of price reduction shall be calculated by unit prices provided in the details of the contract price (Art 29, Para 2, GCCC). This shows that the contract forms allow the employer to omit a part of the work.

3.3 Are there terms which will/can be implied into a construction contract?

It depends on the background facts of the contract's formation. Since there is no specific requirement for the formation of a construction contract, implied terms or obligations may be found by the court or arbitrator, based on the background facts.

3.4 If the contractor is delayed by two events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; or (b) the costs occasioned by that concurrent delay?

Under the GCCC/GCDC/ENAA, the contractor is entitled to an extension of time. However, there is no specific provision or court

precedent which handles the concurrent delay. Unless otherwise stipulated in the contract, the court or arbitrator may consider the concurrent fault or risk event of the employer when it determines from when the delay is attributable to the contractor.

3.5 If the contractor has allowed in his programme a period of time (known as the float) to allow for his own delays but the employer uses up that period by, for example, a variation, is the contractor subsequently entitled to an extension of time if he is then delayed after this float is used up?

No, there are no such specific terms.

3.6 Is there a limit in time beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and from what date does time start to run?

Theoretically, it is possible for the parties to agree to a limitation in time on possible claims. It may be deemed as the waiving of a right by the creditor, to the extent that the agreed limitation is shorter than the period prescription provided in the statute of limitations.

3.7 Who normally bears the risk of unforeseen ground conditions?

The GCCC provides that if the contractor discovers any obstruction to the construction work at the site, the contractor shall immediately notify the administrative architect of this in writing (Art 16, Paras 1 and 2, GCCC). It is also provided in Para 4 of its Article that if it is necessary to vary the scope of work as well as the extension of time for completion, the additional amount shall be agreed by the employer, the administrative architect and the contractor, through consultation.

Unless parties use such major contract forms, the contractor may have to bear the risk of unforeseen ground conditions. In a fixed-sum contract the court found that the contractor may not claim any additional costs, unless the court finds the situation to be extraordinarily unfair (Tokyo High Ct, Judgment of 29 March 1984, 1115 Hanrei Jiho 99). The court considered some factors in order to determine whether or not they were unfair, such as whether: (i) the conditions were unforeseeable to the parties; and (ii) the conditions were not attributable to the contractor, but it finally found that the conditions in question were foreseeable.

3.8 Who usually bears the risk of a change in law affecting the completion of the works?

The GCCC provides that either party may, by expressly stating the reason therefor, make a claim for a necessary adjustment to the contract price if the contract price has become apparently inappropriate and improper due to an unforeseeable enactment, revision or abrogation of any law (Art 29, Para 1, GCCC). The GCDB and ENAA have similar provisions. It is pertinent to note that they do not provide an effective mechanism to fix the amount to be added or reduced, since the administrative architect is not empowered to render a decision in this respect.

As a matter of principle for administrative laws, new or revised laws shall apply to the works which have been commenced before the enactment of such laws. In practice, parties will consult each other in case there is any substantial effect on the works. The Building Standard Act (Act No. 201 of 1950, as amended) (the "BSA") is unique in providing that any revision or amendment to the provision of the BSA shall not apply retrospectively to a work being constructed at the time of revision or amendment.

3.9 Who usually owns the intellectual property in relation to the design and operation of the property?

Design documents, including but not limited to drawings, are eligible as a subject matter of copyright. Copyrights to them shall be vested in the architect who created them. Furthermore, once the building is completed in accordance with the drawings, the copyright to the building shall be vested in the architect, as long as the building meets the requirements of architectural works. A contract for design and build work, such as the GCDB, allows an architect or a contract who actually made a design to keep the copyright. The ENAA is silent on this matter, maybe because it is usually used for industrial plant construction work, where copyright rarely becomes an issue.

3.10 Is the contractor ever entitled to suspend works?

The GCCC provides four situations where the contractor may suspend the work. They are: (1) the employer's delay in making advance or partial payment; (2) the employer's unreasonable rejection of consultation in the case of unforeseeable ground conditions, discrepancies between the drawings and site, etc. (the employer is obliged to accept consultation as per Art 16); (3) impossibility of continuation of the work due to site conditions or *force majeure*; and (4) an extraordinary delay of work due to a cause attributable to the employer. Other major forms also have similar provisions.

Unless parties use such major forms or unless the employer is explicitly obliged to make a payment prior to the completion of the works, the contractor is not entitled to suspend the work. The employer's credibility to make further payments would be an issue if the contract only had a provision of termination, not of suspension. The Tokyo District Court allowed the contractor to suspend the work when the employer's *alter ego* company was found bankrupt (Tokyo Dist Ct, Judgment of 19 Mar 1976, 840 Hanrei Jiho 88). However, it is worth noting that the court does not always allow the contractor to suspend or terminate the works just because the employer's affiliated company goes bankrupt.

3.11 On what grounds can a contract be terminated? Are there any grounds which automatically or usually entitle the innocent party to terminate the contract? Do those termination rights need to be set out expressly?

Most of major contract forms provide cause of termination for the employer and contractor. The core concepts of these causes are breach of contract and lack of credibility for payment or further works. In addition, the contractor may terminate the contract in case of *force majeure* (Para (1)(c), Art 32, GCCC). The employer may also terminate the contract without any cause before the completion of the work (Art 641, Civil Code). The employer's partial termination has been an issue among academics, and the prevailing view refutes it. In practice, the employer's partial termination is usually treated as omission or variation, which causes price adjustments.

Unless parties use such major forms, or unless the employer explicitly agrees to certain terms of termination, parties can still terminate the contract as long as it establishes the other party's breach of contract.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the injured party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

As a traditional civil law jurisdiction, Japan has the concept of *force majeure*, but does not have that of frustration. Furthermore, most contract forms have provisions for *force majeure*, as a cause of extension of time and termination.

Theoretically, the core effect of *force majeure* is to prevent the contractor from being liable for delays to the work. Except where the work is no longer possible due to *force majeure*, the contractor has to resume and complete the work once the influence of *force majeure* ceases to be in play. Whether or not the contractor is entitled to claim additional costs for resuming and recovering the work, is a matter of argument. In principle, the contractor has to resume and recover the work at its own cost. Contrarily, most major contract forms provide that parties have to consult each other first, and if the parties agree to find that the contractor's losses (*songai*) on the uncompleted works, materials and equipment were substantial, and good care of these was not taken, the employer shall indemnify the contractor for such losses (Art 21, GCCC). As such, solutions given by the major forms are still ambiguous and limited.

3.13 Are parties which are not parties to the contract entitled to claim the benefit of any contract right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the original contracts in relation to defects in the building?

As long as the employer and the contactor agree to grant to the third party a beneficiary right, it is possible for such third party to take the benefit, including a claim relating to defects. Unless otherwise, it may be difficult to rely on contractual claims but tort claims may be vested in such third parties, as long as such claims threaten the basic safety of the building.

3.14 Can one party (P1) to a construction contract which owes money to the other (P2) set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

Either party can set off against the sum due to the other party; however, set-offs against any claim arising from tortious acts are prohibited (Art 509, Civil Code).

3.15 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine?

Parties owe a supplementary duty (*fuzui-gimu*) to each other based on the "principle of good faith"(*shingi-soku*), such as the obligation to provide each other with the necessary information. For instance, where the contractor provides the employer with wrong information, it may be found that the employer is entitled to cancel the contract based on a breach of the supplementary duty of the contractor (Nagaya Dist Ct, Judgment of 15 September 2006, 1243 Hanrei Times 145).

3.16 Where the terms of a construction contract are ambiguous are there rules which will settle how that ambiguity is interpreted?

Japanese courts endeavour to interpret and find a reasonable intention of the parties in each particular type of transaction. Sometimes such a reasonable intention found by the courts may depart from the literal meaning of the words used in the contract. Trade usage may be strong evidence for such interpretation.

3.17 Are there any terms in a construction contract which are unenforceable?

As long as terms are not against public policy, terms agreed by the parties shall be respected.

3.18 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

There is no limitation on the extent of the designer's obligation. Where there is any defect in a building which threatens the basic safety of the building, and the defect is attributed to the design, the designer shall be liable for the damage caused by the defect incurred not only by the employer but also by a third party, in accordance with tort theory (Sup Ct, Judgment of 6 July 2007, 1984 Hanrei Jiho 34).

4 Dispute Resolution

4.1 How are disputes generally resolved?

Generally, litigation is the most popular among other dispute resolution procedures, such as arbitration and mediation. In addition, in the construction industry, the CBA stipulates the "Construction Dispute Board" (*kensetu-koji-funso-shinsa-kai*) (the "CDB") as providing the government-sponsored alternative dispute resolution procedure (Art 25, CBA). The CDB is established in every prefecture, and there is a nationwide CDB. The jurisdiction of each CDB is determined by the registered venue of the claimant, or the venue of the construction site in question. Central and prefectural governments appoint a panel of mediator-arbitrators. The CDB provides mediation and arbitration services. Furthermore, summary courts and some district courts provide mediation services, whereas private mediation services are rarely used in any of the industry sectors. Arbitration is also rarely used. Even in the construction industry, litigation is used more often than arbitration.

4.2 Do you have adjudication processes in your jurisdiction? If so, please describe the general procedures.

There are no statutes stipulating "adjudication". Court-supported mediators are sometimes allowed to render determination-like adjudication procedures, and a mediator's determination becomes final and binding unless parties expressly disagree with the proposal (Art 17 and 18, Civil Mediation Act, Act No. 222 of 1951, as amended).

4.3 Do your construction contracts commonly have arbitration clauses? If so, please explain how arbitration works in your jurisdiction.

The use of arbitration for domestic disputes is quite low in Japan. It is the same in the construction industry. However, compared with

other business sectors, it seems that construction arbitrations, mainly handled by the CBD, amount to around 90 cases – three to four times as the number of regular commercial arbitrations handled by the Japan Commercial Arbitration Association.

Usually, parties do not agree to arbitration at the time of conclusion of the construction agreement. If any dispute arises, either party (or parties) refers the dispute to the CDB mediation, and some parts of the dispute are settled by mediation. If parties find that it is more efficient to refer the remaining issues to the same CDB members, then they go to arbitration. Otherwise, they go to court for litigation.

4.4 Where the contract provides for international arbitration do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles to enforcement.

Since the Arbitration Act (Act No. 138 of 2003, as amended) is enacted based on the UNCITRAL Model Law and Japan has acceded to The United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards 1958 (the "New York Convention"), Japanese courts usually recognise and enforce international arbitration awards made in Member States of the New York Convention. Further, there is no unique obstacle against enforcement.

4.5 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction?

This question depends on the country in which the judgment is made. Article 118 of the Code of Civil Procedure (Act No. 109 of 1996, as last amended by Act No. 30 of 2012) provides the following requirements for the judgment of the foreign court to be upheld and enforced in Japan: (1) the jurisdiction of the foreign court is recognised under laws or conventions; (2) the defeated defendant has received the service of a summons or order necessary for the commencement of the suit or has appeared; (3) the judgment and the court procedures are not contrary to public policy in Japan; and (4) a mutual guarantee exists between the country and Japan. Accordingly, the judgment of the foreign court would not be enforceable unless a mutual guarantee exists between Japan and the foreign country in which the judgment was made.

4.6 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

A civil procedure is commenced by a plaintiff filing a complaint with a court. A defendant receives the complaint and a writ of summons from a court. In response to this, the defendant files an answer with a court. After that, in general, each party submits its argument and evidences several times, and court hearings, including examination of witnesses, are held several times. In general, it takes one (1) to two (2) years to receive a decision by the first instance court.

Japan's court system is basically a three-trial system in which parties to disputes have the right of appeal (*koso*) and final appeal (*jokoku*). It generally takes two (2) to three (3) years from filing a complaint to receiving a decision ruled by the final court of appeal (i.e. the Supreme Court).

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Nagashima Ohno & Tsunematsu, having offices in Tokyo, New York, Singapore, Bangkok and Ho Chi Minh City, is widely known as a leading law firm and one of the foremost providers of international and commercial legal services in Japan. The firm's construction team has advised on many construction and infrastructure projects in various jurisdictions including China, Taiwan, Vietnam, Indonesia, India, Pakistan, Sri Lanka, Iraq and African countries as well as Japan. The firm has advised owners, construction companies, engineering and design companies in various types of construction projects including office buildings, super high-rise condominiums, entertainment parks, museums, crude-oil pipelines, highways, bridges, thermal/nuclear power plants, chemical and paper-mill plants and various other kinds of industrial plants. The firm regularly represents clients in international and domestic arbitration/mediation procedures. Many members of the construction team are active in construction committees in the International Bar Association, Inter-Pacific Bar Association, Dispute Resolution Board Foundation and International Academy of Construction Lawyers; some are national members of the ICC Arbitration Committee.

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- Alternative Investment Funds
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- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Construction & Engineering Law
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Recovery & Insolvency
- Corporate Tax
- Data Protection
- Employment & Labour Law
- Environment & Climate Change Law
- Franchise
- Gambling
- Insurance & Reinsurance
- International Arbitration
- Lending & Secured Finance
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Patents
- Pharmaceutical Advertising
- Private Client
- Product Liability
- Project Finance
- Public Procurement
- Real Estate
- Securitisation
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks

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