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■CORPORATE GOVERNANCE

Recent Developments in Japanese Corporate Governance

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I. Introduction

Two significant reforms to the corporate governance regime of Japanese listed companies are being implemented this Spring. Effective on May 1, 2015, the amended Companies Act has introduced a new governance structure and additional requirements relating to outside directors. Furthermore, starting June 1, 2015, the Tokyo Stock Exchange (the "TSE") will adopt the Japanese Corporate Governance Code (the "Code") which was developed on the initiative of the Financial Services Agency of Japan (the "FSA").

These reforms represent a major step forward in bringing Japan's corporate governance regime closer to the systems more widely accepted globally and which are familiar to overseas investors. Citing the "uniqueness" of Japan's management style, Japanese firms have generally been slow to respond to overseas investors' calls for more transparent governance. Backed by the strong political initiative of the current administration, these corporate governance reforms aim to boost investor confidence in Japanese listed firms. These reforms, particularly the Code, are also designed to foster healthy entrepreneurship by providing a framework for transparent, fair and quick business decisions, rather than restricting corporate management.

Part II of this article summarizes governance-related amendments to the Companies Act that are relevant to Japanese publicly-traded companies. Part III of this article provides an overview of the Code.

II. Amendments to the Companies Act

The amendments to the Companies Act that came into effect in May 2015 were perhaps the most extensive since the introduction of the Act nine years ago. The two major pillars of the amendments are enhanced corporate governance and regulations concerning parent companies and subsidiaries. Key amendments for enhanced corporate governance are set out below.

1. New corporate governance structure

The amended Companies Act has introduced a third corporate governance structure for Japanese listed firms called a company with an audit and supervisory committee (*kansatouiinkai secchi kaisha*).

Formerly, Japanese public companies had two choices of governance structure: one with a board of statutory auditors (*kansayakukai secchi kaisha*) (ie., the "statutory auditors structure") and another with nomination, audit and compensation committees (*shimeiiinkai tou secchi kaisha*) (ie., the "three committees structure"). The former, the statutory auditors structure, is a traditional corporate governance structure whereby statutory auditors (*kansayaku*), the majority of which must be outside members, are tasked with monitoring management and also directors. By contrast, the three committees structure was modeled after the U.S.-style governance system with the board of directors serving more as an independent monitoring body than a decision-making body. Due to the requirement that a majority of the members of each committee must be outside directors, the three committees structure has not been widely adopted since its introduction in 2003. At the time of writing this article, over 98% of TSE-listed firms retain the statutory auditors structure.

The third system, or the audit and supervisory committee structure, is a hybrid of the existing two structures. Under the new structure, an audit and supervisory committee comprised of at least three directors (of whom a majority are outside directors) is tasked with monitoring the management of business by executive board members. In addition to the rights and duties similar to those of statutory auditors under the statutory auditors structure, audit and supervisory committee members, as directors, have the right to vote at board meetings, enabling them to exercise more effective supervision than statutory auditors as statutory auditors have no voting powers. Also, unlike with the three committees structure, companies with an audit and supervisory committee are not required to have nomination and compensation committees dominated by officers appointed from outside the company, easing the skepticism which many Japanese boards felt towards the effectiveness of external directors.

As of the date of writing, more than 150 listed firms have announced the adoption of the audit and supervisory committee structure, quickly overtaking the number of companies with the three committee structure in a matter of only months. This shift away from the traditional statutory auditors structure is expected to continue with the introduction of the Code, which, as discussed in Part III of this article, recommends having multiple outside directors.

2. Stricter eligibility requirements for outside directors and statutory auditors

Prior to the amendment, the definition of outside directors (*shagai torishimariyaku*) and outside statutory auditors (*shagai kansayaku*) was generally criticized as not requiring a sufficient level of independence from company management. Under the amended eligibility requirements, the following persons are not eligible to be an outside director or outside statutory auditor of a listed company:

(i) a director, executive officer or employee of the company's parent company;
(ii) an executive director, executive officer or employee with an executive position at the company's sister company, and
(iii) the spouse or a relative within the second degree of kinship of any director or a manager or other important employee of the company or a controlling shareholder of the company.

Persons falling within (i) and (ii) above can regain eligibility ten years after his or her resignation, provided certain other requirements are met. Further, the above

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requirements remain less stringent than the eligibility requirements for "independent outside directors" or "independent outside statutory auditors" (collectively, *dokuritsu yakuin*) set out in the TSE rules (see paragraph 2 of Part III below).

3. Expanded availability of contractual limitation of liability

Under the amended Companies Act, a company may enter into a contract with any non-executive director or any statutory auditor pursuant to which the director's or statutory auditor's liability to the company may be limited, provided that he/she had no knowledge of the unlawfulness of his/her act(s) and was not grossly negligent in the performance of his/her duties. There is a statutory minimum liability amount, which is generally equal to his/her annual compensation multiplied by two, unless a greater amount is determined by the company within the limit prescribed in the articles of incorporation.

4. "Comply or explain" approach for outside directors

As of February 2015, more than 30% of all the TSE-listed firms had no outside directors. After a lengthy debate, the introduction of a mandatory outside director under the Companies Act was rejected. However, a public company without any outside director is now required to explain at its annual shareholders' meeting the basis upon which it believes that appointing one is not appropriate for the company. As discussed in paragraph 3 of Part III below, the TSE rules, however, impose additional requirements in relation to the election of external board members.

III. Overview of the Japanese Corporate Governance Code

1. The Code: a "principle-based" and "comply or explain" approach

The proposed Code was announced in March 2015 by the FSA after seven months of deliberation, in stark contrast to the four years of deliberation for the amendments to the Companies Act discussed above. The Code generally reflects the OECD Principles of Corporate Governance and due consideration was given during deliberations to the corporate governance regimes of the United Kingdom and other major jurisdictions. A provisional English translation of the Code is published by the FSA at the following link: http://www.fsa.go.jp/en/refer/councils/corporategovernance/20150306-1/01.pdf

Unlike other regulations in the area of corporate law that employ a rule-based approach, the Code adopts a principle-based approach whereby each listed company is expected to make its own judgments as to how to interpret and apply the principles laid out in the Code by taking into account the individual circumstances of each company. Furthermore, the Code employs a so-called "comply or explain" approach whereby each public company can either comply with the Code, or if it considers that any part of the Code is not appropriate for the company given its circumstances, explain why the company does not comply with the Code. Following the incorporation of the Code into the rules of the TSE on June 1, 2015, the failure to explain non-compliance with any part of the Code, as opposed to non-compliance with the Code itself, will be subject to sanctions by the TSE.

2. Code framework and the five "guiding principles"

The Code consists of five "guiding principles", 30 "principles" and 38 "supplementary principles." Japanese companies listed on the First and Second sections of the TSE must expressly explain in their corporate governance reports any election not to comply with any of these principles. By contrast, companies listed on the emerging market sections (ie., the Mothers and JASDAQ sections) are required to explain non-compliance with any of the five guiding principles only. Given the short period between the announcement of the Code and its adoption by the TSE, the TSE allows for a special six-month extension for a first submission of renewed corporate governance reports.

The ultimate purpose of the Code is to promote sustainable growth and increase corporate value over the mid- to long-term through individual companies' self-motivated governance and action. The five guiding principles of the Code are: (i) securing the rights and equal treatment of shareholders, including foreign shareholders and minority shareholders; (ii) engaging in appropriate collaboration with stakeholders other than shareholders, such as employees, customers, trading partners, and local communities; (iii) ensuring transparency and the appropriate disclosure of financial, managerial or other information; (iv) ensuring that

the board of directors is responsible for, among others, establishing the broad direction of the company's strategies, and independent and effective oversight of the management; and (v) engaging in constructive dialogue and engagement with shareholders.

3. Responsibilities of the Board of Directors and Independent Outside Directors

Reflecting the central role of the board of directors in corporate governance, the Code extensively describes the fourth guiding principle: the responsibilities of the board of directors. In a refreshingly unprecedented manner, the Code expressly states that one of the roles of the board is to support appropriate risk-taking by management. The Code promotes various systems to encourage healthy entrepreneurship and effective monitoring by the board, including (i) an executive compensation scheme designed to provide proper incentives for management with an appropriate ratio of compensation linked with mid- to long-term performance and a well-balanced allocation of cash and equity components; (ii) providing directors with training on their roles and duties and, for outside directors, on the company (the company's policy on which should be disclosed); and (iii) providing directors and statutory auditors with all necessary information and access to internal staff or external professionals.

Perhaps the most controversial principle of the Code was that listed firms should appoint at least two independent outside directors (*dokuritsu shagai torishimariyaku*). Although this requirement may appear modest or even insufficient to some inbound investors, this is a challenging requirement for most Japanese boards which have long been dominated by internally appointed members. In order for a prospective director to qualify as "independent" under the TSE rules, he or she must be free of conflict of interests with public shareholders and must meet more stringent eligibility requirements than the outside director requirements set forth in the Act (see paragraph 2 of Part II above). For example, the prospective director should not be a director, executive officer or employee of the company's major customers or other major business partners.

The various requirements on external board members can be summarized as follows. Each listed firm must have at least one independent outside director or statutory auditor (*dokuritsu yakuin*) under the TSE rules. If a listed firm does not have two independent outside directors, under the Code it needs to explain why it does not have those independent outside directors. If a listed firm does not have any outside director at all, the Companies Act requires the company to explain why it is not appropriate for the company to have any outside director.

4. Cross-Shareholding

The Code also shines a spotlight on cross-shareholdings, one of the characteristics of Corporate Japan often criticized by overseas investors. Under the Code, large-cap listed companies that hold shares of other listed companies for policy reasons, including for cross-shareholding purposes, should disclose their policy with respect thereto, and the board of directors should annually review and explain the mid- to long-term economic rationale and future outlook of such shareholdings. In addition, companies with cross-shareholdings and other shareholdings for non-investment purposes should establish and disclose their policies in relation to the exercise of their voting rights in such shareholdings.

IV. Conclusion

The corporate governance reforms discussed above appear to have obtained positive feedback inside and outside of Japan. No corporate governance mechanism, however, is perfect and the success of the foregoing reforms will depend upon continuous efforts by Japanese listed companies to live up to the spirit of these reforms through enhanced transparency and accountability to their investors and stakeholders. The level of determination of Japanese listed firms will become known later this year when the majority of those firms are required to submit their initial corporate governance reports under the new framework.

Liberalization of Japan's Electricity Industry

Introduction

Fundamental reform of Japan's power system is underway. The radiation leaks from Fukushima after the devastating 2011 earthquake undermined the Japanese people's confidence in the safety of nuclear power. The consequent tight electricity market after the suspension of nuclear power plant operations to allow inspections exposed defects in the current system resulting in doubts as to whether the existing system could secure a supply of "cheap and reliable" electricity into the future.

The current reforms aim to secure the supply of "cheap and reliable" electricity by implementing market and competition principles, instead of the traditional regional monopolies and regulation of electricity charges. The lack of competitiveness in Japan's electricity industry is due to inactive trading in wholesale electricity markets, unclear access rights to electricity transmission/distribution networks and restrictions on entry into retail electricity business. To increase overall competitiveness, various measures shall be taken including increasing competition in wholesale electricity markets, securing fairer access to electricity transmission/distribution networks and boosting competition in retail electricity markets. To reduce electricity supply costs, the demand of electricity shall be responsive to market price signals. Namely, electricity supply shall be optimized by introducing nation-wide "merit orders", "mega-watt trading" (ie, conserving electricity and other energy which generates excess electricity supply capacity shall be allocated trading value) and "demand response" (ie, electricity demand shall respond to supply capacity rather than supply responding to fluctuations in demand).

Three-Step Reform

The outline of the current electricity reforms is set out in the government's "Policy on Electricity System Reform". Principal objectives of this reform are reducing electricity charges, securing reliable electricity supply and expanding users' choices and utilities' business opportunities. To achieve such objectives, the principal measures are developing cross-regional system operation (instead of traditional intra-regional system operation), fully liberalizing the electricity retail, generation and wholesale sectors and enhancing the impartiality of the electricity transmission/distribution sector by introducing mandatory legal separation of electricity utilities.

Accordingly, amendments to the Electric Business Act will be implemented in the following three steps:

(a) First step (establishment of the Organization for Operating Cross-regional Systems): the Act for Partial Amendment to the Electric Business Act ("First Amendment") which was promulgated on November 20, 2013 (the provisions relevant to the Organization for Promoting Cross-Regional Operations was effective from April 1, 2015).

(b) Second step (full liberalization of entry into the electricity retail sector): the Act for Partial Amendment of the Electric Business Act ("Second Amendment") which was promulgated on June 18, 2014 (the provisions relevant to full liberalization etc. of entry into the electricity retail sector will become effective within two and a half years from the above promulgation date).

(c) Third step (enhancement of the impartiality of the electricity transmission/distribution sectors by way of mandatory legal separation of utilities and full liberalization of electricity retail charges): a bill of the Act for Partial Amendment to the Electric Business Act ("Third Amendment") was submitted to the ordinary session of the Diet in March 2015 and, if promulgated, mandatory legal separation of utilities will become effective from 2020 and full liberalization of electricity retail charges will be effective in a region if the competition in the electricity retail market is sufficiently developed that liberalization of electricity prices will not harm the interests of users within that region from 2020 or thereafter.

First Step: Establishment of the Organization for Promoting Cross-regional Operations, etc. (amendment effective from April 1, 2015)

1. Promotion of Cross-regional Operations

The Organization for Promoting Cross-regional Operations (the "Organization") was established to develop the electricity transmission/distribution networks necessary for promoting cross-regional utilization of power resources, so as to enhance nation-wide adjusting of electricity supply and demand to secure a reliable electricity supply. The Organization is dealing with matters of great public interest and accordingly the enactment and amendment of its Articles of Incorporation and appointment or removal of its directors and officers require the government's approval. All electricity utilities must be the members of the Organization. The Organization may impose fines or other sanctions against utilities that do not comply with its instructions for sharing power, etc. Furthermore, upon the Organization's advice, the Minister of Economy, Trade and Industry may issue an order for electricity supply against any utility to secure a reliable supply of electricity.

2. Amendment to "Self-Wheeling" System

To secure reliable supply, owners of in-house power generation facilities should be able to effectively use such power generation facilities. After this amendment, if an owner of in-house power generation facilities requests existing utilities companies (i.e., the ten regional utilities including Tokyo Electric Power and Kansai Electric Power) to provide electricity transmission/distribution services so as to supply electricity to its own factories, etc. ("self-wheeling") and if the utilities reject such request without a justifiable reason, then the Minister may order the utilities to provide the relevant transmission/distribution service.

3. Amendment regarding Orders for Restrictive Use of Electricity

Before this amendment, so as to order restrictive use of electricity, the Minister could issue only a stringent order accompanied by penalties. After this amendment, however, the Minister may also make a "recommendation" as a less stringent measure to urge restrictive use of electricity.

Second Step: Full Liberalization of Entry into Electricity Retail Sector, etc. (amendment to become effective from 2016)

While supply of electricity to large-volume users had been already liberalized, supply of electricity to households and other small-volume users is still regionally monopolised by utilities companies. After this amendment, however, any retail electricity utilities, if registered, may supply electricity to households and other small-volume users. Reflecting this amendment, categorization of electricity business will be also changed from the current categories such as "general electricity business" and "specified-scale electricity business" to "retail electricity business" (for which only registration is required) and "business of electricity transmission/distribution" (a license is required for "general electricity transmission/ distribution business" and "electricity transmission business", while only notification is required for "specified electricity transmission/distribution business") and power generation business (for which only notification is required). Please note, however, that such "full liberalization" is subject to considerable numbers of special transitional treatments aiming to protect electricity users and to secure a reliable supply of electricity for certain transitional periods.

(a) Retail Electricity Sector

After the amendment, any person, if registered, will be able to enter into the retail electricity business sector. However, for protection of users and securing a reliable electricity supply, such registered person will be obligated to ensure the supply of electricity sufficient to meet its customers' demands. Similarly, such registered person will have various other obligations such as explaining contract terms, producing certain documents to its customers, dealing with customers' complaints, prohibitions on being a nominee or shell company and publicizing suspension or discontinuance of its businesses. If it does not comply with these obligations, sanctions including an order to improve its operation, cancellation of its registration and/or penal penalties may apply. As a special transitional treatment to protect households and other

small-volume users (having less bargaining power against utilities) after retail electricity business is fully liberalized, the existing general electricity utilities (which shall be categorized as "deemed retail electricity utilities") will be provisionally obligated to supply electricity to satisfy the demand in the relevant ex-monopolized region at the charges regulated under the "Specified Retail Supply Provisions" approved by the government. If the competition among retail utilities grows sufficiently strong in a region in the future, such special transitional treatment might be abolished in such region.

(b) Electricity Transmission/Distribution Businesses

Due to its highly public nature, licensing and other strict regulations for this category of electricity business will be maintained:

(i) General Electricity Transmission/Distribution Business

The electricity transmission/distribution business currently conducted by the electricity transmission/distribution department of the currently-existing general electricity utilities will be regulated as the "general electricity transmission/distribution business". To secure reliable supply of electricity, strict regulations thereon will be maintained such as: (A) the wheeling charge will be regulated pursuant to the currently adopted fully distributed cost method; (B) imposing an obligation to deliver electricity to users by use of electricity transmission/distribution networks maintained and operated by such utility (obligation to provide "wheeling service"); (C) imposing an obligation to supply electricity to users who may not obtain electricity from retail electricity utilities (obligation to provide "last resort electricity supply guarantee service"); (D) imposing an obligation to supply electricity to users in isolated islands at charges similar to levels in other regions (obligation to provide "universal electricity supply service to isolated islands"); and (D) imposing certain other obligations.

(ii) Other Electricity Distribution Business

The business of maintenance and operation of electricity distribution facilities conducted by persons other than the above currently-existing electricity transmission/distribution service providers will be regulated as the "electricity distribution business" which requires the government's license and will be obliged to provide cross-regional wheeling services and certain other obligations.

(iii) Specified Electricity Transmission/Distribution Business

The "own-wheeling" (supplying electricity to users in specified areas (town district, etc.) by maintenance and operation of its own electricity transmission/distribution facilities) services, which is currently conducted by the Specified Electricity Utilities (such as Roppongi Energy Service, Co., Ltd.) and some of the specific-scaled electricity utilities (PPS), will be regulated as the "Specified Electricity Transmission/Distribution Business" which will require only a notification to the government and will be required to provide wheeling services and have certain other obligations.

(c) Power Generation Business

Currently, a government license is required to do wholesale business of large-volume and long-term electricity to general electricity utilities and only J-POWER and The Japan Atomic Power Company are the players. After this amendment, however, power generation businesses will be required to give a notification to the government only if using power generators of a certain scale and the current restrictions upon wholesale electricity charges will be abolished. Even after this amendment, however, once an electric power generator agrees to generate power or supply electricity for the operators of the general electricity transmission/distribution businesses, then such power generator will be obligated not to refuse such agreed power generation and/or electricity supply without a justifiable reason. And as a safety net for a possible nation-wide shortage of electricity (ultimately to ensure a reliable electricity supply into

the future), the Organization for Promoting Cross-regional Operations will promote the construction of power plants by opening tenders to the manufacturers or operators of power plants.

(d) Public Recognition of and certain Regulations regarding Wholesale Electricity Exchanges

Currently, wholesale electricity power exchanges are private markets not subject to regulation. However, it is anticipated that after the liberalization of power generation and electricity retail sectors, the importance of electricity transactions in wholesale electric power exchanges will increase. After this amendment, wholesale electric power exchanges will be statutorily recognized and subject to certain regulation such as the prevention of market manipulation and other wrongful trading, government market monitoring and certain other measures to ensure appropriate operation of the exchanges.

(e) Electricity Futures Trading

In accordance with the increase of trade volume of electricity on wholesale electricity power exchanges in the future, the necessity for an electricity futures market will increase. Accordingly, electricity, an intangible asset, will be added to the assets eligible for trading under the Commodity Futures Act all of which assets are currently tangible assets.

Third Step: Securing Further Impartiality of Electricity Transmission/Distribution Sector and Full Liberalization of Electricity Retail Charges, etc. (amendment to become effective from 2020 and thereafter)

To secure better impartiality of the operation of electricity transmission/distribution services so that electric power generators and retail electricity utilities can fairly use the transmission/distribution networks, after this amendment comes into effect, in general, one person/entity may not conduct both electricity transmission/distribution business and electricity retail/wholesale business. To comply with such rule, the existing general electricity utilities shall transfer the electricity transmission/distribution business to separate legal entities by business transfer, corporate split (*kaisha bunkatsu*) or other method ("legal separation"). Furthermore, to secure fair and impartial competition among electricity retail companies, a person may not assume both a directorship of a company of electricity transmission/distribution services and a directorship of its group company of electricity generation or electricity retail business.

Full deregulation of electricity retail charges will not be implemented (in other words, transitional regulation upon regional electricity retail charges will be maintained) "for the time being", but in 2020 or thereafter, the government may abolish such regulation in respect of a region in which appropriate competition sufficiently grows and where it is considered that abolishment of regulation upon charges will not harm the relevant electricity users.

Has Pandora's Box been Opened?

Retail electricity business and various other business opportunities will be generated by these electricity reforms. Electricity may be supplied at cheaper charges than today so long as an increased number of persons/entities enter into the electricity retail business and sufficient competition grows therein in the future. Meanwhile, the liberalization of electricity business may cause or increase unfortunate incidents such as blackouts in vast areas due to a lack of investment in renewal of power generation facilities, insolvency of retail electricity utilities or other causes. Therefore, these new electricity reforms should be prudently implemented considering the vast experience of many other countries having a long history of liberalizing the electricity market before Japan.

Newly Introduced Concession-type PFI in Japan

Privatization of Government Services and Public Infrastructure Projects

Motivated by concerns regarding the country's massive national debt, which reportedly exceeded 1 quadrillion yen (roughly 10 trillion US dollars) in 2013, the government of Japan ("Government") has taken steps to facilitate greater privatization of government services and projects related to infrastructure, in particular through the enactment of legislation intended to stimulate Private Finance Initiative transactions ("PFI"). In 2011, the Government announced its plan to raise the level of PFI investments in Japan to at least 10 trillion yen (roughly 100 billion US dollars) by 2020 and the PFI Law was amended in the same year to achieve this ambitious goal.

The primary aim of the amendment was to encourage financially free-standing projects ("FFSPs") in which the private-sector contractor's only payment recourse for its investment is the future revenue stream from the project itself (mainly, usage fees from users of the public facility or service). As the cost of the project is borne by users and not the Government, FFSPs are likely to have a great impact in terms of reduction of the national debt. The amendment resulted in the introduction of a new type of PFI ("Concession-type PFI") in which private sector operators are awarded rights ("Concession Rights") to manage and operate public facilities or properties owned by the Government (Article 2, Item 7, PFI Law).

Concession Right

The amendment to the PFI law provided that the Government or any local government ("Administrator") may grant a Concession Right to a private sector operator ("Concession Operator") (Article 16, PFI Law), and such Administrator may receive compensation from such Concession Operator as consideration for the granting of such Concession Right (Article 20, PFI Law).

(a) Fee for the Provided Service

A Concession Operator is permitted to charge a usage or service fee to those members of the public who use the services of the public facility/property operated by the Concession Operator and retain such amounts as its own revenue (Article 23, Item 1, PFI Law). In addition, a Concession Operator is authorized to determine and also adjust the usage fee, such as landing fees at an airport or water and sewerage charges, by submission of a prior written notice to the applicable Administrator (i.e., the Administrator's approval to fees and charges determined by Concession Operators is not required) (Article 23, Item 2, PFI Law). This amendment provides greater flexibility to Concession Operators by allowing them to freely determine the usage or service fee amounts after taking into account relevant factors such as demand and their respective business strategies, thereby strengthening an investor's position.

(b) Some unresolved issues

One aspect of Concession Rights which requires further clarification is rescission of the assigned rights, and in particular how and under what circumstances an assigned Concession Right can be rescinded, and in the event of rescission, to what extent the affected Concession Operator will be compensated. Article 29, Item 1 of the PFI Law provides limited grounds for rescission of a Concession Right, however some of the stated grounds are unclear. For example, Article 29, Item 1, subsection 2 identifies an "unavoidable necessity in terms of public interest arising in relation to one of the other public uses of the Public Facility" as a grounds for rescission of a Concession Right, but it would be impossible to foresee the types of situations which may justify rescission of a Concession Right Holder without there being any "fault" on the part of the Concession Operator. In the case of a rescission on the grounds of "unavoidable necessity" in terms of public interest arising in relation to one of the other public uses, the affected entity (i.e., the former holder of the Concession Right) is to be compensated by the Government pursuant to Article 30 of the PFI Law. Losses subject to compensation are stipulated as "any loss that would ordinarily arise" due to the rescission. From this language, the precise amount of

compensation payable cannot be easily determined. In practice, the grounds for rescission of a Concession Right and the method for determining the amount of compensation to be paid therefore should be clearly stated in the Concession Right assignment agreement with the Government to protect the Concession Operator's rights and interest.

Projects in Progress

1. Airports

There are 27 airports in Japan owned and managed by the Government and many of them are operating at a loss according to the Ministry of Land, Infrastructure, Transport and Tourism ("MLIT"). MLIT is considering privatizing many of these airports, such as Sendai Airport, New Kansai International Airport and Osaka International (Itami) Airport, through Concession-type PFI as the most effective way of returning these airports to profitability.

2. Roads

The enactment of a new law (or amendment of an existing law) would be necessary for an Administrator to assign a Concession Right regarding the operation of a toll road facility to a private sector entity. However, it seems that an enactment or amendment of laws for this purpose has not yet been considered by the Government. In light of this, some Administrators are considering using a special zone (tokku) system through which an Administrator may assign Concession Rights for the operation of toll road facilities without enacting new laws or amending existing ones. Among them, Aichi prefecture has been considering using Concession-type PFI for its toll roads.

3. Water Services & Sewage Systems

Administrators face the ambitious task of maintaining and operating current water and sewage systems in the future when revenues are expected to decrease due to reduced usage resulting from the anticipated population decline in Japan. To address this challenging situation, each Administrator will need to consider how to maintain and operate those facilities more cost effectively, and the use of Concession-type PFIs seems to be an attractive option. On March 31, 2014, MLIT published its guideline for the implementation of Concession-type PFIs in relation to sewage system operations in order to facilitate PFI in this sector. As a result, Osaka City (Osaka Prefecture) and Hamamatsu City (Shizuoka Prefecture) have announced their interest in introducing Concession-type PFIs for their water service and sewage system operations.

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