

THE PROJECTS AND
CONSTRUCTION
REVIEW

NINTH EDITION

Editor
Júlio César Bueno

THE LAWREVIEWS

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CONSTRUCTION
REVIEW

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PREFACE

*La meilleure façon d'être actuel, disait mon frère Daniel Villey,
est de résister et de réagir contre les vices de son époque.*

Michel Villey, *Critique de la pensée juridique modern* (Paris: Dalloz, 1976)

This book has been structured following years of debates and lectures promoted by the International Construction Law Committee of the International Bar Association, the International Academy of Construction Lawyers, the Royal Institution of Chartered Surveyors, the Chartered Institute of Arbitrators, the Society of Construction Law, the Dispute Resolution Board Foundation, the American Bar Association's Forum on the Construction Industry, the American College of Construction Lawyers, the Canadian College of Construction Lawyers and the International Construction Lawyers Association. All these institutions and associations have dedicated themselves to promoting an in-depth analysis of the most important issues relating to projects and construction law practice and I thank their leaders and members for their important support in the preparation of this book.

Project financing and construction law are highly specialised areas of legal practice. They are intrinsically functional and pragmatic, and require the combination of a multitasking group of professionals – owners, contractors, bankers, insurers, brokers, architects, engineers, geologists, surveyors, public authorities and lawyers – each bringing their own knowledge and perspective to the table.

I am glad to say that we have contributions from new jurisdictions in this edition: Ghana and the Philippines. Although there is an increased perception that project financing and construction law are global issues, the local knowledge offered by leading experts in 19 countries has shown us that to understand the world, we must first make sense of what happens locally; to further advance our understanding of the law we must resist the modern view (and vice?) that all that matters is global and what is regional is of no importance. Many thanks to all the authors, and their law firms who graciously agreed to participate.

Finally, I dedicate this ninth edition of *The Projects and Construction Review* to a dear friend, the late John (Jack) Bernard Tieder, Jr, who died on 3 December 2017. Jack was the founding partner of Watt, Tieder, Hoffar & Fitzgerald LLP and the Global Construction and Infrastructure Law Alliance. He is much missed and I am most grateful for his friendship, and all his support and guidance during my path as a construction lawyer. He leaves behind a large extended family and many close friends and esteemed associates around the world.

Júlio César Bueno

Pinheiro Neto Advogados, São Paulo

June 2019

A dedication to Jack Tieder (1946-2017)
by Professor Doug Jones AO

Jack Tieder was one of the doyens of the International Construction Bar.

Graduating from John Hopkins University and Syracuse and American University School of Law in 1971, he commenced practice as lawyer with the firm of Lewis Mitchell & Moore where he progressed to the ranks of partnership. In 1978 he was a founding partner of the firm then called Watt Tieder Killian & Hoffar and was the senior partner of the firm now known as Watt Tieder Hoffar & Fitzgerald from March 1978 until his passing.

Over the course of his career he contributed to international construction projects practice through the establishment of project delivery and financing structures that ensured success for many major projects around the world. As counsel in court and arbitration he was formidable.

Jack though was more than an attorney. He was a contributor to legal education around the world and to the development of collegiate practice of construction law in the United States and elsewhere in the world. An example only was his foundation fellowship of the American College of Construction Lawyers.

I knew Jack for many years and his commitment in a variety of ways outside the law to the assistance of young people wanting to make their way in the law and to education of lawyers in parts of the world outside his home country was quite extraordinary. For many years he coached teams at the Willem C Vis Moot and regularly lectured in eastern Europe and Russia to local practitioners to bring to them an international perspective of the practice to which they aspired.

Jack was a runner of some note, who during his life maintained a fitness regime that was the envy of his friends. His expertise in, and love of, beer was legendary.

In recent times, Jack undertook a significant amount of work as an arbitrator and it has been my privilege to sit with him in that role. His experience of practice around the world equipped him well to decide disputes in the international construction context and his capacity for incisively cutting to the chase on the key issues in complex cases was awe-inspiring.

In a case recently concluded I worked with Jack in hearings during the period in which he was undergoing some quite significant medical procedures. His cheerful acceptance of what for many would be regarded as seriously debilitating effects of surgery and other treatment was inspiring to those of us who were working with him. His mind remained sharp until the end and in very recent times his dedication to the conclusion of issues in the case was remarkable, his work insightful and his judgement impeccable. Upon recent news of the return of his illness, he faced the position with courage and amazing good humour.

We have lost a giant of the construction law industry, who will remain a legend to all who knew him.

It has been our privilege to have Jack as a Fellow and mine to have him as a colleague and a friend.

He will be missed by all of us, but not nearly as much as by Rufus and the family. At this time all our thoughts and prayers are with Rufus and the children and grandchildren with whom doubtless the memories of Jack's personality and contribution to their lives will remain strong forever.

JAPAN

Naoki Iguchi, Makoto (Mack) Saito and Rintaro Hirano¹

I INTRODUCTION

The main assets for project finance in Japan are power plants and public infrastructure.

After the first project financing transaction took place in the late 1990s in relation to conventional power projects, private finance initiative (PFI) projects were at the centre of the project finance field.

The Japanese government enacted the Act on Promotion of Private Finance Initiative Funds (Act No. 117 of 1999, as amended (the PFI Act)), which initiated a boom in PFI projects. As PFI projects contemplated project finance debts, the project finance market developed in line with the expansion of the PFI market. Furthermore, after the PFI Act was amended in 2011 to introduce concession arrangements, project finance has been used for a wider range of infrastructure assets.

In addition, the Act on Special Measures on Procurement of Electricity from Renewable Energy Sources by Electricity Utilities (Act No. 108 of 2011, as amended (the Renewable Energy Act)) boosted the development of renewable solar and wind plant projects nationwide.

II THE YEAR IN REVIEW

Investment in infrastructure is one of the core initiatives of the Japanese administration, which aims to invest ¥21 trillion in infrastructure projects between 2013 and 2022. The government considers the concession scheme to be a key tool in accomplishing that goal. Since the privatisation of two international airports in the Kansai region in 2016, many airports have been or will be privatised by way of this scheme. Furthermore, the government advocates using the concession scheme for other assets, such as toll roads, water purifying plants, sewerage facilities, hydraulic power plants and convention centres. The procurement of concessions has commenced for some of these assets.

Construction of new conventional power plants has been expected in recent years because it is not clear when the nuclear plants, whose operations have been suspended, will be allowed to resume operations and many of the conventional power plants are facing renewal deadlines. However, owing to the global trend against coal-fired plants, and for commercial reasons, several projects to create new conventional power plants have been cancelled.

The growth of the renewable energy sector is expected to continue but government policy regarding the feed-in tariff (FIT) system is changing because of criticisms regarding the rapidly increasing public costs for maintaining the FIT system.

¹ Naoki Iguchi, Makoto (Mack) Saito and Rintaro Hirano are partners at Nagashima Ohno & Tsunematsu.

With respect to offshore wind farm projects, while a commercial-based project has yet to emerge, a new act that provides for a legal framework in which a project company for an offshore wind farm can use the sea area for up to 30 years was passed by Parliament and its ancillary executive regulations have been promulgated. We hope this legislation will give some momentum to the offshore wind industry.

III DOCUMENTS AND TRANSACTIONAL STRUCTURES

i Transactional structures

Common vehicles used as project companies are joint stock corporations and limited liability companies. Sponsors inject equity by way of pure equity (or legal equity) and subordinated loans. Regarding the latter, the Money Lending Business Act (Act No. 32 of 1983, as amended) does not fully exempt intra-group lending. Generally, a shareholder that owns less than 20 per cent would not be allowed to provide loans to the project company.

In addition to pure equity and subordinated loans, *tokumei kumiai* (TK) investments have often formed part of equity. A TK investment is made under a TK contract, which is a bilateral contract whereby one party (the TK operator) receives funds from the other party (the TK investor), and with those funds conducts certain pre-agreed business and shares the profit generated from this business with the TK investor. The business is conducted in the name of the TK operator and the TK investor's liability is limited to an obligation to make an investment of the pre-agreed amount. The TK operator can enter into TK contracts for the same business with multiple TK investors, in which case, taken as a whole, the structure will be economically very similar to a limited liability partnership in which the TK operator is a general partner and the TK investors are limited partners. Under a TK contract, profit and loss allocated to the TK investors is directly recognised by the TK investors, not by the TK operator.

Under the PFI Act, although various delivery structures have been adopted, the majority of PFI projects are availability-based accommodation projects, which use the build-to-order (BTO) structure. The ownership of an accommodation facility is transferred from the project company to the procuring authority upon its completion, and the accommodation facility is maintained by the project company thereafter.

In a concession project, the right to operate a subject infrastructure facility is granted to the project company while the ownership of the facility is retained by the public authority.

ii Documentation

A typical set of documents to be entered into in a project finance transaction are as follows:

- a* a PFI (concession) contract between the project company and a procuring authority, or a power purchase agreement between the project company and a power utility;
- b* a design-and-build (D&B) contract between the project company and a D&B contractor, or an engineering, procurement and construction (EPC) contract between the project company and an EPC contractor;
- c* an operation and maintenance (O&M) contract between the project company and an O&M contractor;
- d* a fuel supply contract between the project company and a fuel supplier;
- e* direct agreements between the lenders and the counterparties to various project documents;
- f* an insurance agreement between the project company and insurance companies;

- g* finance agreements, including senior credit facility agreements, interest rate swap agreements, intercreditor agreements and security agreements; and
- h* a shareholders' agreement between the project company's shareholders and the project company itself.

In relation to a construction contract, the Construction Business Act (Act No. 199 of 1949, as amended) (CBA) requires that a construction contract be made in writing, stipulating that there must be at least 14 items provided in the CBA to make the contract terms clear and unequivocal (Article 19, CBA).

iii Delivery methods and standard forms

Project finance lenders usually require that a construction contract be a date-certain, fixed-price and lump-sum contract. As a means of satisfying this requirement, construction agreements in which project finance is involved often take the form of a D&B or EPC contract.

With regard to the delivery structure of construction projects, typically a contractor performs the work in accordance with the design provided by an owner or owner-retained designers. Typical standard forms for this delivery structure are (1) the public work standard contract (last amended in 2017) published by central government and providing the general conditions for public works, and (2) the general conditions for construction contract (GCCC) (last amended in 2017) for the private sector. The GCCC was jointly drafted by several industry associations that respectively represented owners, developers, designers and contractors. It is the most widely used standard form and is generally used with special conditions prepared by the parties. Accordingly, when the GCCC is used in a project financing transaction, it is often amended by way of special conditions so that it will satisfy the project finance lenders' requirements.

For D&B contracts, the general conditions for design-build contract (GCDB) (last amended in 2012), drafted and published by the Japan Federation of Construction Contractors, is the only published standard form. The GCDB was prepared by a contractors' association to promote the D&B delivery structure. Nonetheless, unlike D&B forms used in international construction projects, the design and construction parts of the GCDB are easily separable; the parties proceed to the construction phase only after the owner confirms the contractor's design products.

For industrial plant construction work, EPC contracts are widely used. The Engineering Advancement Association's general conditions for domestic plant construction work (the ENAA-Domestic) (last amended in 2011), drafted and published by the Engineering Advancement Association (one of the contractors' associations), integrates design, construction and commissioning phases into a single contract; however, in reality, full turnkey EPC contracts are not frequently used for the construction of industrial plants, such as chemical process plants and power plants, unless project finance debt is procured. As a result, EPC forms are most commonly used in renewable energy projects, as they are usually financed by project finance debt. However, the ENAA-Domestic is not widely used in the market; more often, EPC forms that have been developed by contractors or project sponsors are used.

For PFI projects, the PFI Act does not specify any particular delivery structure. Various delivery structures have been adopted under this Act, including, in order of the most

common: BTO, build-operate-transfer, build-transfer and build-own-operate.² There are no publicly available standard forms of contract; however, for local governments' reference, central government has published a sample BTO contract, a Guideline on Contracts – Notes for PFI Project Contracts (2003) and a Guideline for Risk Allocation in PFI Project (2001).

For design work and supervision services for construction work, the industry associations that jointly drafted the GCCC also publish the General Conditions for Design Work and Supervision (last amended in 2015).

IV RISK ALLOCATION AND MANAGEMENT

i Management of risks

Obstructions at the site

The GCCC provides that if a contractor discovers any obstructions to construction work at a site, the contractor shall immediately notify the administrative architect in writing (Article 16, GCCC). It also provides that if it is necessary to vary the scope of work, the additional amount shall be agreed by the employer, the administrative architect and the contractor, through consultation.

Unless the parties use these types of major contract forms, a contractor may have to bear the risk of unforeseen ground conditions. In a fixed-price contract, Tokyo High Court found that the contractor may not claim any additional costs, unless a court finds the situation to be extraordinarily unfair (Tokyo High Court, judgment of 29 March 1984, 1115 *Hanrei Jiho* 99). The Court considered certain factors to determine whether or not they were unfair, such as whether the conditions were not foreseeable by the parties and whether the conditions were not attributable to the contractor. It ultimately found that the conditions in question were foreseeable.

Force majeure

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

Theoretically, the core effect of force majeure is to prevent a contractor from being liable for delays to the work. Except where the work is no longer possible because of force majeure, the contractor has to resume and complete the work once the influence of force majeure ceases to be in play. Whether the contractor is entitled to claim additional costs for resuming and recovering the work is a matter of debate. However, most major contract forms provide that parties have to consult each other first, and if the parties agree that the contractor's losses on the uncompleted work, materials and equipment were substantial, and good care of these was not taken, the employer shall indemnify the contractor for those losses (Article 21, GCCC). As such, solutions provided by the major forms are still ambiguous and limited.

² http://pfi-as.jp/case/cat4692/post_29.html.

ii Limitation of liability

The concept of limitation of liability is generally accepted under Japanese law. It is common in particular types of projects, such as renewable energy. Furthermore, liquidated damages, which are caused by breach of contract, including but not limited to delay in completion and the agreed level of performance not being achieved, are also accepted under Japanese law and sometimes limit the amount of actual damages.

Foreign investors should note that a defaulting party may be liable for tort as well as for breach of contract. If there are defects in a building that jeopardise its basic safety and the defects are attributed to the design, the designer shall be liable for the damage caused by the defects incurred not only by the employer but also by a third party under the tort theory (Superior Court, judgment of 6 July 2007, 1984 *Hanrei Jihō* 34).

iii Political risks

The GCCC provides that either party may, by expressly stating its reason, make a claim for a necessary adjustment to the contract price if it is being used inappropriately or improperly owing to unexpected legislation (Article 29, GCCC); however, the GCCC does not provide an effective price adjustment mechanism, leaving it to the parties to negotiate and agree. This kind of ambiguity is found in the majority of domestic projects and construction contracts.

V SECURITY AND COLLATERAL

In project finance transactions, project finance lenders normally request security interests on most of a borrower's assets. For real property, mortgages and revolving mortgages are common forms of security interest created for the benefit of project finance lenders, and these mortgages and revolving mortgages may be perfected by registration. For shares of companies and rights (e.g., rights for account receivables, rights for bank accounts, rights for insurance proceeds and leasehold rights) pledges and revolving pledges or security by way of transfer are used, depending on the type of asset. Generally, the pledge, revolving pledge and security by way of transfer may be perfected by consent from or notice to the obligor with a certified date.

Additionally, project finance lenders reserve the rights to assign to themselves, or third parties designated by the project finance lenders, project-related contracts entered into by a borrower to enhance the step-in rights of the project finance lenders.

In traditional project finance transactions in Japan, sponsors are often obliged to provide monetary support to project companies in recourse events. In the past, pure non-recourse loans, in which sponsors owe no direct contractual liability to project finance lenders, have not been widely used. However, in more recent years, there have been more non-recourse loans (rather than limited recourse loans) in project finance transactions for renewable energy power plants.

VI BONDS AND INSURANCE

With the exception of a construction agreement in relation to a conventional public procurement (without project finance debt being employed), performance bonds are not widely used in construction agreements, except for projects in which international sponsors are involved. If performance bonds are required for such a project, they often take the form of a demand guarantee under the Uniform Rules for Demand Guarantees published by the International Chamber of Commerce.

The following are typically procured in relation to project finance:

- a* erection all-risk insurance (during construction);
- b* third-party liability insurance (during construction and operation);
- c* delay in start-up insurance (during construction);
- d* all-risk insurance (during operation);
- e* business interruption insurance (during operation); and
- f* any other insurance statutorily required for the business conducted by the project company.

VII ENFORCEMENT OF SECURITY AND BANKRUPTCY PROCEEDINGS

Project finance lenders normally safeguard their step-in rights through a combination of (1) security interests created over most of the assets and rights in connection with the project, and (2) reservation of rights to assign project-related contracts to the project finance lenders or designated third parties. In exercising its step-in rights in the event of a default, a project finance lender will first try to assign the project to a third party that it has designated, with voluntary cooperation by the project company and its sponsors using the pressure of the step-in rights. If the project company and its sponsors are not cooperative, the project finance lender will unilaterally exercise its step-in rights, which may include foreclosure of security interests.

Generally, in a bankruptcy proceeding or a civil rehabilitation proceeding, secured creditors may still foreclose their perfected security interests outside the bankruptcy or civil rehabilitation proceeding and collect the proceeds of foreclosure. However, in a corporate rehabilitation proceeding that is applicable to stock companies (not limited liability companies), secured creditors may not exercise their security interests outside the corporate rehabilitation proceeding.

VIII SOCIO-ENVIRONMENTAL ISSUES

i Licensing and permits

For the development of power plants or other infrastructures, all the applicable permits, certifications and notifications relating to the development must be obtained and implemented. In addition to nationwide regulations, in most cases there are multiple layers of local regulations set by prefectures, cities, towns, villages and wards that may include a requirement to conduct an environmental impact assessment.

ii Equator Principles

Some of the leading Japanese banks have adopted the Equator Principles, and typical covenants and representations required by the Principles commonly appear in project finance documentation.

IX PPP AND OTHER PUBLIC PROCUREMENT METHODS

i PPP

Before the concession scheme was introduced in 2011, most PFI projects were availability-based accommodation projects (e.g., schools, government offices, public housing, hospitals, school catering service facilities and libraries); transport sector projects, such as Haneda International Airport, were exceptions, although PFI can be used for various types of infrastructure and is flexible. The amendment of the PFI Act in 2011 aimed to change this situation and to develop the PFI regime to accommodate broader PPPs that can be used for various types of infrastructure projects. Under the concession scheme, a concessionaire is allowed to collect from the general public a commission, toll, fee or other moneys for the use of the infrastructure it operates. As such, the concession scheme is considered an appropriate form for a project in which the private sector assumes all or part of the revenue and demand risk.

In most PFI and PPP projects, the bidding process is in two stages. Only the bidders that pass the first stage are invited to the second stage, and the winner of the second stage becomes a preferred bidder. In recent projects, a competitive dialogue has been conducted during the second stage. Proposals from bidders are evaluated by scoring various aspects of the proposal based on the standards prescribed in the tender documents. The preferred bidder is usually not allowed to further negotiate a contract with the procuring authority after it has been chosen as the preferred bidder. As such, it does not take much time to conclude the contract once the preferred bidder is selected. Most of the work done after the preferred bidder is selected is in relation to the finance documents, and the project finance lenders are usually required to accept the terms of the contract agreed between the bidder and the procuring authority.

ii Public procurement

There is no legislation in Japan that deals directly with public procurement; the Public Account Act (Act No. 35 of 1947, as amended) (in relation to procurement by central government) and the Local Autonomy Act (Act No. 67 of 1947, as amended) (in relation to procurement by local governments) refer to the permitted forms of public procurement (i.e., open competitive tender, restricted competitive tender and negotiated procedure) and their respective procedures.

Although criminal sanctions apply to persons who commit serious violations of procurement procedures (e.g., graft or cartel activity), there is no specific cause of action available to losing bidders that can stop the procurement procedure or the conclusion of the contract.

X DISPUTE RESOLUTION

i Special jurisdiction

Generally, litigation at court is the most popular dispute resolution procedure. Although there is no special jurisdiction of special courts for projects and construction disputes, district courts in Tokyo and Osaka have a section called the building division. Nonetheless, foreign investors should note that Japanese courts, even those with building divisions, are generally not familiar with expert analysis on delay because there are almost no experts in this area. District courts also provide court-sponsored mediation services (private mediation services are rarely used in any of the industry sectors).

ii Arbitration and ADR

The CBA designates the ‘construction dispute board’ (CDB) as the government-sponsored alternative dispute resolution (ADR) procedure (Article 25, CBA). There are local CDBs and a central CDB. The jurisdiction of each CDB is determined by the registered office of the claimant or the construction site in question. Central and local governments appoint a panel of mediator-arbitrators. The CDB is not frequently used as an instrument in international construction practices, but is a kind of conciliation tool purely formulated for domestic disputes. It is not advisable for foreign investors to rely too much on the CDB procedure.

The most widely recommended dispute resolution is arbitration. Although arbitration is seldom used for domestic disputes in Japan, the Arbitration Act (Act No. 138 of 2003, as amended) is modelled after the 1985 UNCITRAL Model Law. The Japan Commercial Arbitration Association is the most reliable national arbitration institution, but any foreign arbitration institution can be chosen instead. The language of arbitration is English.

XI OUTLOOK AND CONCLUSIONS

The project finance market in Japan still has room to expand but, in the areas of concession-type PFI projects and offshore wind farm projects (among others), the potential for expansion depends on the level of deregulation by the national government.

The role of local governments is also important as they have the power to initiate or support various projects that are potential targets for project financing.

ABOUT THE AUTHORS

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Naoki Iguchi is a partner in the international projects and arbitration practice team of Nagashima Ohno & Tsunematsu. He has been advising construction companies, investment companies and infrastructure management companies in construction, transport, crude oil pipeline and other infrastructure projects in various jurisdictions, including Asia, the Middle East, Africa and the Americas. Mr Iguchi also provides advice to national and foreign construction and investment companies that have projects in Japan, including advising construction projects for famous entertainment facilities. Mr Iguchi has represented many companies in international arbitration in Asia. He was the representative for Japan on the Dispute Resolution Board Foundation and is a regular workshop lecturer for the Overseas Construction Association of Japan, Inc. Mr Iguchi also taught international project law at Keio Law School.

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Makoto (Mack) Saito is a partner at Nagashima Ohno & Tsunematsu (NO&T). He has represented domestic and international energy companies in solar, wind and various other renewable energy project finance transactions. He started his practice in 2000 and has vast experience in project finance, real estate finance and other types of structured finance. Since the feed-in tariffs system was first introduced in Japan in 2012, Mr Saito and other NO&T infrastructure practice team members have dynamically taken the lead role in creating new project finance structures designed for renewable energy projects using their extensive knowledge of energy regulations, real estate regulations, securities regulations and corporate laws. He also regularly advises engineering, procurement and construction contractors, financial institutions and trading companies in energy and infrastructure areas.

He earned an LLB from the University of Tokyo in 1999 and an LLM from University of Michigan Law School in 2006.

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Rintaro Hirano is a partner at Nagashima Ohno & Tsunematsu. He has advised Japanese clients in a number of international projects, and he has experience in negotiating with host-country governments, international lenders, and contractors and sponsors in those projects. In particular, Mr Hirano was involved in large-scale infrastructure projects during a two-year secondment to the Japan Bank for International Cooperation. The sectors he covers range from transport, such as rolling stock, light-rail concession, airports and toll roads, and telecommunications, such as submarine cable systems, to power and energy, including conventional power projects, renewable power projects (solar, wind, etc.) and liquefied natural gas projects.

Mr Hirano earned an MBA from INSEAD in 2009, an LLM from Columbia Law School in 2007 and an LLB from the University of Tokyo in 2000. He is admitted to the Bar in Japan (2001) and New York, United States (2008).

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