

## Guidelines on Risk Allocation, etc. in PFI Projects



The guidelines indicate the points to be noted, etc. when studying the risk allocation, etc. and other aspects of the PFI projects as one of the practical guidelines for the national government in the implementation of PFI projects. The national government of Japan should implement PFI projects in accordance with the Act on Promotion of Private Finance Initiative (Act No. 117 of 1999; hereinafter referred to as the “Act”) and the Basic Policy on the Implementation of Projects on the Private Finance Initiative (Cabinet Decision of October 23, 2018; hereinafter referred to as the “Basic Policy”), and in line with these guidelines. These guidelines can also serve as a reference in PFI projects implemented by persons other than the national government.

These guidelines do not prevent each ministry and agency from ensuring the proper and steady implementation of PFI projects by paying attention to matters beyond those indicated in these guidelines, in accordance with the Act and the Basic Policy, for the smooth implementation of PFI projects.

The PFI has yet to be implemented in full-scale, and based on the implementation status thereof and the progress, etc. of investigations and studies pertaining thereto in the future, a part or all of the guidelines will be changed as necessary or new guidelines will be provided.

Unless otherwise provided herein, the terms used herein shall have the meanings as provided in the Act and the Basic Policy.

## **I. Basic Considerations for Risk Allocation, etc.**

1. At the time of conclusion of an agreement, etc., it cannot be accurately predicted any events that may occur during the project period of a selected project, such as accidents, demand fluctuation, natural disasters, and changes in economic conditions such as price hikes, etc. Should any of these events occur, the expenditure for the project or the income from the project may be affected. In the implementation of a selected project, the possibility of loss due to the uncertain events, the effects of which cannot be precisely assumed at the time of the conclusion of the agreement, etc. is called a risk.
2. For ensuring a proper and steady implementation of a selected project, additional expenditures other than those originally envisaged may be required if risks occur. For this reason, it is necessary for an administrator, etc. of the public facility, etc. and an appointed business to avoid ambiguity to the greatest extent possible and clearly provide measures in the agreement, etc., including the sharing of additional expenditure, in the event that a risk emerges.

It is necessary to note that the risk allocation for the selected project shall be decided in the agreement, etc. based on the idea that "the person who can best manage the risk will bear the risk" after clarifying the assumed risk to the greatest extent possible.

When studying risk allocation, the following points shall be considered based on the sharing of work between the administrator, etc. of the public facility, etc. and the appointed business.

### **(1) Identification of Risks and Their Causes**

Identify risks and their causes in the implementation of a selected project to the greatest extent possible.

### **(2) Evaluation of Risks**

- (a) It is recommended to quantify the additional expenditure that may be required if the identified risks materialize;
- (b) If it is difficult to quantify, it is recommended to qualitatively assess the scale of the impact on the selected project;
- (c) It is also recommended to determine whether or not there are risks that can be mitigated or eliminated by economically rational means, and to estimate the costs associated with the mitigation or elimination.

### **(3) Parties Sharing the Risk**

Either the administrator, etc. of the public facility, etc. or the appointed business shall study who will share the risk, depending on the following:

- (a) The ability to prevent the materialization of risks at a lower cost;
- (b) Whether the person has the ability to minimize the additional expenditure when the risk is

likely to materialize, and if the risk is likely to materialize, depending on whether there are reasons attributable to the person.

(4) Risk Allocation Method

The following risk allocation methods can be considered:

- (a) Either the administrator, etc. of the public facility, etc. or the appointed business bears the entire risk;
- (b) Both parties bear a certain share of the cost (the allocation may be changed incrementally);
- (c) One party shall bear the burden up to a certain amount, and if the amount exceeds the certain amount, the burden shall be allocated in the manner described in (a) or (b);
- (d) Both parties shall bear a certain share of the cost up to a certain amount, and if the amount exceeds a certain amount, the cost shall be allocated in the manner described in (a).

A study shall be conducted on a risk-by-risk basis to determine how to share the additional expenses that would be required in the event of materialization of the risk, taking into account the level of capacity of the person to bear the additional expenses that could be incurred in the event of materialization of the risk.

3. In the study of risk allocation, it is necessary to note that the risks are different for each selected project, and the contents of risk allocation shall be evaluated and studied according to each selected project.

It is also necessary to note that when measures are taken for risks that can be mitigated or eliminated by economically rational means, the scope and content of the measures shall be as specific and clear as possible in the agreement, etc.

In addition, it is necessary to pay attention to the fact that the risk allocation of the parties in the agreement, etc. has a significant impact on the conditions of the selected project, such as the cost of financing, and to make the contents of the agreement appropriate and clear in consideration of economic rationality.

4. If the appointed business is a corporation (including a corporation in which the corporation has invested or contributed) pertaining to the contribution or investment by the national or local government, it is necessary for administrator, etc. of the public facility, etc. to disclose the specific and clear allocation of responsibilities and risks to the appointed business and other interested parties and to give special consideration to maintaining transparency thereof.

## **II. Risk Factors and Points to be Noted in the Study of Risk Allocation, etc.**

In order to contribute to the study of a selected project, the administrator, etc. of the public facility, etc. and the appointed business may, in the implementation of the selected project, provide in the agreement etc. the burden of additional expenditure in case the risk materializes as the following.

In the study of risk allocation, it is necessary to note that the risks are different for each selected project, and the contents of the risk allocation shall be evaluated and studied according to each selected project. Thus, it is necessary to select from the following items or add them separately and study them on the basis of individual cases.

### **1. Risks Related to Survey and Design**

- (1) If a selected project includes part or all of surveying, geological survey, or design (hereinafter referred to as "Design, etc."), "Delay in completion of design, etc.," "Excess of agreed amount of cost for design, etc.," "Defects in the deliverables of design, etc." are assumed to be the main causes.

(Reference)

- ① "Delay in completion of design, etc." refers to a delay in the completion of the deliverables of design, etc. because the deliverables cannot be completed within the period as specified in the agreement, etc., and "Excess of agreed amount of cost for design, etc." refers to the cost for completion of the deliverables exceeding the agreed amount of cost when the volume of design, etc. is specified in the agreement, etc.
- ② Due to insufficient explanation of the site during the process of solicitation and selection of private businesses, the cost of design and construction may exceed the agreed amount. In order to mitigate the risks, the administrator, etc. of the public facility, etc. is expected to provide sufficient explanation, etc. of a selected project to the private business in the process.
- ③ See 3(1), Reference ④(a), for damage caused to a third party in relation to the implementation of the project when geological survey, etc. is included in the selected project.
- ④ If the ownership of the public facility, etc. is transferred to its administrator, etc. of the public facility, etc. during the project period of the selected project, defects in the survey results may affect the later stages of design, construction, maintenance and operation, and defects in the design may affect the later stages of construction, maintenance and operation. Therefore, it is recommended to specify the period of claim for repair of defects and compensation for damages to the appointed business, and to study in advance the measures

to be taken in the later stages according to the period required for repair of defects, and to provide them in the agreement, etc.

- (2) In the context of each selected project, it is recommended for the administrator, etc. of the public facility, etc. to specify the rights and obligations of the appointed business in the agreement, etc. while taking into consideration that the involvement should be kept to a minimum, and to study the risk allocation of the administrator, etc. of the public facility, etc. according to the degree of impact on the selected project involved.

(Reference)

- ① Even if the process of design, etc. is expected to delay the start of operation, or the cost of design, etc. exceeds the estimated amount, in the event that the impact on the entire selected project is expected to be small by allowing the appointed business to conduct its business on its own until the start of operation, depending on its capability to cope with the situation. However, it may not be appropriate for the administrator, etc. of the public facility, etc. to bear the excess cost, collect damages due to delay, request detailed reports, or give instructions. However, even in the above case, it is recommended to specify the cost sharing based on the division of work.
  - ② There are cases in which, in the design work contract, etc. used for ordinary public works, if the ordering party changes the documents for any reason, such as actual differences in the natural or artificial conditions of performance as indicated in written documents such as drawings, specifications, site manuals, and answers to questions about site descriptions, etc., the period of performance or the work consignment fee will be changed as necessary, or if the ordering party incurs damage, the necessary costs will be borne.
  - ③ Even if design, etc. is not included in the selected project, its delays by the administrator, etc. of the public facility, etc., or errors or omissions in the deliverables of the design, etc., may cause delays or interruptions in each stage of construction, maintenance and operation, or cause the costs required in each stage to exceed the agreed amount. It is therefore advisable to specify the measures to be taken for delays when the design, etc., is carried out by the administrator, etc. of the public facility, etc., and the period of claim for repair of defects and compensation for damages to the administrator, etc. of the public facility, etc., and to study in advance the measures to be taken at a later stage and the period required to repair the defect, and to provide them in the agreement, etc.
- (3) If the implementation of the selected project requires long procedures such as environmental impact assessment procedures, which may result in significant changes in the content of the public facility, etc., the selected project may be affected by changes in the design, the land to be

secured, etc. It is, therefore, recommended to study in advance whether the administrator, etc. of the public facility, etc. or the appointed business shall take the relevant measures when there are delays, and changes in the contents of the public facility, etc., and to provide them in the agreement, etc.

## 2. Risks Related to Land Acquisition

If the selected project includes part or all of the acquisition of land for the project, such as acquisition of site of the public facility, etc., acquisition of the right to use the land temporarily for a certain period of time, etc., which is necessary for the construction of the project, it is assumed that the land acquisition will be delayed or the cost of land acquisition will exceed the agreed amount.

Even if the selected project does not include the acquisition of land for the project, delays in securing land for the project or change of site for the project may cause interruptions or delays in the design, construction, maintenance and operation phases, or the costs required in each phase may exceed the agreed amount.

Therefore, it is recommended to study in advance which of the two parties, the administrator, etc. of the public facility, etc. or the appointed business, will be responsible for the acquisition of the land for the project, the delay of the acquisition, and the measures to be taken at each stage of change of the site for the project, and to provide them in the agreement, etc.

## 3. Risks Related to Construction

(1) When a selected project includes all or part of construction, the following risks are expected to occur: "Delay in the completion of construction," "Excess of agreed amount of construction cost," "Damage to third parties in connection with construction," "Defect of the subject matter of the construction work," etc.

(Reference)

① Delays in the completion of construction will occur due to inappropriate process management by the appointed business, changes in design caused by the administrator, etc. of the public facility, etc., delays in the construction of facilities closely connected with the public facility, etc. related to the selected project of the administrator, etc. of the public facility, etc. or other parties; and force majeure or other circumstances beyond the control of both the parties that cannot be avoided regardless of reasonable measures taken by the parties to the agreement, etc. In the event of a delay in the completion of a project, the appointed business may incur losses such as additional labor costs and interest on loans, while the administrator, etc. of the public facility, etc. may incur losses such as the cost of purchasing alternative services. If the appointed business has notified the completion of the public facility, etc., and as a result of the commissioning of the facilities and equipment, it is



not possible to achieve the level of public services to be provided as indicated in the agreement, etc., specifications, etc., under the conditions of the public facility, etc., the work is not deemed completed. It is necessary to agree in the agreement, etc. that the completion of the repair thereof shall constitute the completion of the work.

- ② Excess of agreed amount of construction cost means that the construction cost exceeds the agreed amount because the construction cannot be completed at the amount initially specified in the agreement, etc. due to various reasons. This may be caused by an increase in the cost required to shorten a certain part of the construction process, an increase in the cost arising from changes in construction materials due to design changes, or an increase in the cost of major construction materials, etc.
- ③ If the ownership of the public facility, etc. is transferred to the administrator, etc. of the public facility, etc. during the project period of the selected project, since defects in the public facility, etc. may affect maintenance and operation, it is recommended to specify the period of claim for repair of defects and compensation for damages to the appointed business, and to study in advance the measures to be taken for repair of the defects, and to provide them in the agreement, etc.
- ④ Some cases of construction contracts used for ordinary public works are as follows:
  - a. A case where, in principle, the contractor shall compensate for any damage caused to a third party in connection with the construction work. However, if the damage is caused by reasons attributable to the ordering party, such as the ordering party's instructions or the nature of the goods lent, or if the damage is caused by noise, vibration, disconnection of underground water, etc., which cannot be normally avoided in the course of construction, the ordering party shall, in principle, bear the amount of compensation;
  - b. A case where the contractor shall bear the costs of any damage to the construction works, construction materials, and any other general damage caused by the construction work (excluding damage to third parties and damage caused by force majeure), except for damage caused by reasons attributable to the ordering party.
  - c. A case where, if construction works cannot be performed due to force majeure, etc., the contractor is required to change the construction period or the contract price as necessary, or to bear the increased cost, etc. to the contractor due to the suspension of construction. (See 6(1) Reference ④ for the sharing of damage to the construction work etc. in the event of force majeure.)
  - d. See 6(2) Reference ④ for cost allocation in the event of price increases, etc.
  - e. A case where the contractor shall provide fire insurance, etc. for the subject matter of the construction work and construction materials.

(2) The administrator, etc. of the public facility, etc. shall consider minimizing the involvement of the appointed business for individual selected project and specify the rights and obligations in the agreement, etc., and studies the risk allocation of the administrator, etc. of the public facility, etc., according to the degree of impact on the selected project.

(Reference)

- ① In some cases of construction contracts used for ordinary public works, when natural or artificial construction conditions shown in documents such as drawings, specifications, site instructions, and answers to questions about site instructions differ from actual conditions, or when unforeseen special conditions arise with respect to construction conditions that are not clearly indicated, and if the ordering party changes these documents for any reason, the construction period or the contract price may be changed as necessary, or the contractor shall bear the necessary costs for sustaining damages.
- ② Even if the construction is not included in the selected project, such as when the administrator, etc. of the public facility makes small-scale repairs to the existing facility and leases it to the appointed business, there may be delays or interruptions in the maintenance and operation of public facilities due to delays in lending by the administrator, etc. of the public facility, etc. or defects in the facilities, or the costs required for the maintenance and operation may exceed the agreed amount. Therefore, it is recommended to specify the measures to be taken for the delays, the period for claiming for repairing of the defects and compensation for damages to the administrator, etc. of the public facility, etc., as well as to study in advance the measures to be taken according to the length of period required for repairing the defects, and to provide them in the agreement, etc.

#### 4. Risks Related to Maintenance and Operation

If the selected project includes part or all of the maintenance and operation, it is necessary to consider factors including "Delay in the start of operation," "Difference in the degree of utilization of public services from the initial assumption," "Interruption in maintenance and operation," "Damage to facilities," "Accident related to maintenance and operation," "Technological innovation," and "Defects in repair parts, etc."

- (1) Delay in the start of operation may be caused by delays in the preliminary design, land acquisition, and construction, delays in the establishment of an appointed business necessary for the provision of public services, and delays in various procedures to be completed before the start of public services. Therefore, it is recommended to study the measures to be taken for the delays in advance and provide them in the agreement, etc.

(2) The following cases may cause the risk of the difference in the degree of utilization of public services from the initial assumption:

- (a) When changes in socioeconomic conditions reduce the need for public services provided by the selected project, and the actual degree of utilization is lower than initially expected.
- (b) When the level of actual use of the public service provided by the selected project is lower than initially expected due to the availability of similar services.

For this reason, when deciding on the income of the appointed business (payment of service fees, etc. by the administrator, etc. of the public facility, etc. to the appointed business, usage fees collected by the appointed business themselves, etc.) in the agreement, etc., it is recommended to study the method to be adopted, considering the nature of the individual selected project, such as whether or not to collect user fees from users of public services, and to make arrangements for appropriate risk allocation in the event of a difference in the degree of utilization of public services from that initially expected.

(Reference)

- ① In case the selected project includes an operational part, a special consideration is required because the arrangement of the payment of service fees, etc. by the administrator, etc. of the public facility, etc. to the appointed business and the usage fees to be collected by the appointed business themselves will determine the risk allocation between the administrator of the public facility, etc. and the appointed business.
- ② Service fees, etc. to be paid by the administrator, etc. of the public facility, etc. to the appointed business may be paid in the following ways (for each of them, a fixed amount or unit price may vary over time and in stages):
  - a. A fixed amount (e.g., when the initial investment, such as construction cost, accounts for a large proportion of the total cost of the selected project, and the proportion and amount of the cost required for operation is small);
  - b. The amount obtained by multiplying a certain unit price by the degree of utilization of the public service (e.g., when the cost of operation accounts for a large proportion of the total cost of the selected project);
  - c. A fixed amount plus a variable amount based on the degree of utilization of the public service (e.g., when the cost required for the entire selected project is large, and both the initial investment cost and the cost required for operation are large, and the degree of utilization is assumed to fluctuate over time).

In the case of (a), the degree of utilization of the public service and the revenue will no longer be linked; however, it is necessary to note that the linkage with future increases in costs will also be severed. In addition, in case of (a), income may fluctuate greatly depending on the degree of use. It is necessary to note that when the degree of use is large,

it can cover the fluctuations of the unit price, and that the fluctuations can cover the fluctuations in the degree of use; however, there can be a trade-off between the unit price and the degree of use.

(3) It is recommended to consider the following cases where the risk of interruption in maintenance and operation materializes, study the measures including the sharing in advance, and provide them in the agreement, etc. to the greatest extent possible:

- (a) When the actual number of times and period required for maintenance and inspection, etc. exceed those initially assumed based on the nature of the public facility, etc.;
- (b) When it is difficult to obtain raw materials, etc. essential for providing public services; or
- (c) In the case of (4) Damage to facilities, (5) Accident, or 6(3) below.

(Reference)

- ① It is recommended to study whether the interruption in maintenance and operation should be total or partial as specified in the agreement, etc., as well as the duration of the interruption.
- ② If the interruption in maintenance and operation is caused by reasons not attributable to the appointed business, the period of providing the public service will be shortened due to the interruption. Therefore, it is recommended to study in advance the payment of service fees, etc. by the administrator, etc. of the public facility, etc. to the appointed business in the extension of the project period, and make arrangements in the agreement, etc. to the greatest extent possible.

(4) Damage to facilities can be assumed as follows:

- (a) Those arising from hidden defects in the installation of facilities;
- (b) Those caused by defects in the management of the facility; or,
- (c) Those caused by acts of a third party.

It is recommended to study in advance how to share the burden in each case, considering the degree of funds required for the restoration of the facility, whether it is due to reasons attributable to the administrator, etc. of the public facility, etc. or the appointed business, and the ability of the relevant party to bear the additional expenditure, and to make arrangements in the agreement, etc. to the greatest extent possible.

(Reference)

- ① In case of damage to the facilities, in addition to the cost of repairing, there may be losses such as the cost of providing public services in temporary facilities, etc. before the main facilities are repaired, and loss of profit during the interruption period.
- ② Damage to facilities may also cause harm to a third party such as users of public services.

Therefore, it is recommended that in such cases, the way of sharing the burden be studied beforehand and agreed upon in the agreement, etc. to the greatest extent possible, considering the reasons attributable to the appointed business and the administrator, etc. of the public facility, etc., and their ability to bear the burden.

(5) Accidents related to the maintenance and operations are assumed to be as follows:

- (a) Those arising from defects in the installation of the facility;
- (b) Those arising from defects in the management of the facility; or,
- (c) Those arising from the operation itself.

It is recommended to study in advance how to divide the costs in each case, considering the degree of funds required for compensation for damages to third parties, the reasons attributable to either the administrator, etc. of the public facility, etc. or the appointed business, and the ability of the relevant party to bear additional costs, and make arrangements in the agreement, etc. to the greatest extent possible.

(Reference)

- ① If an accident is caused by a defect in the installation of the facility, the cost of its improvement will be incurred. Therefore, it is recommended to study in advance how the cost should be shared, and make arrangements in the agreement, etc. to the greatest extent possible.
- ② Accidents arising from the operation of the service itself may include those caused by the operation of vehicles, those caused by defects in the product in the case of a selected project that produces some kind of product, and damage to or loss of goods entrusted by users of the public service, etc.

(6) The following are assumed to materialize when risks related to technological innovation become apparent:

- (a) When, at the time of the conclusion of the agreement, it is assumed that the technology used in the provision, etc. of public facilities, etc. will become obsolete after a certain period of time and, although the cost of technological alternatives and changes to some facilities and equipment is specified in the agreement, etc., and the actual cost of changes in facilities and equipment required exceeds the initial assumption;
- (b) When the technology adopted in the provision, etc. of the public facility, etc. becomes obsolete and lose of efficiency and competition due to technological innovation that was not expected at the time of the conclusion of the agreement, etc., and additional investment is required for the provision etc., of the public facility, etc. introducing new technologies to continue the selected project.

Therefore, it is recommended to study in advance the measures to be taken, including the sharing of costs in each case, considering the extent of funds required for changes in facilities and equipment, and to provide them in the agreement, etc. to the greatest extent possible.

(Reference)

- ① If the technology employed in the provision, etc. of public facilities, etc. is no longer the latest, due to technological innovation not envisioned at the time the agreement, etc. was originally concluded, it is to be noted that partial modification of facilities and equipment may not always be necessary if efficiency and competition are ensured and socially useful.
- ② The cases in which additional investment in (b) is required include the suspension of the supply of repair parts for the public facility, the suspension of the provision of services by other third parties that are inseparable from providing public services by the public facility, etc. If the selected project takes a long period of time, it is very difficult to predict in advance the amount of additional investment that will be required when situation (b) occurs at the time of the conclusion of the agreement, etc. It may be beneficial to provide in the agreement, etc., the matters that are expected to be necessary, such as consultation procedures among the parties to the agreement, etc., implementation of investigations by third-party experts, and sharing of costs in the event of the situation described in (b).
- ③ When considering the extent of funds required to modify some of the facilities and equipment of the public facility, etc. in addition to the funds required for the additional investment, it is necessary to compare and weigh the burden of each party in the entire selected project after the change of the facilities and equipment, taking into account the decrease in maintenance and operation costs due to the improved efficiency after the additional investment.

(7) Damages to a third party related to defects of repairs parts in connection with the repair, etc. of the public facility, etc. shall be agreed upon in the agreement, etc. in the same manner as arrangements for damages to third parties and defects in the subject matter of the construction work, etc.

(8) In addition to (3) through (7) above, the following cases can be assumed in which the maintenance and operation costs exceed the agreed amount:

- (a) When the maintenance and operation costs exceed the initial assumption due to 6(2) below;  
or
- (b) When the level of use of the public service exceeds the initial assumption, and the maintenance and operation costs exceed the initial assumption.

It is recommended to consider the extent to which the cost of maintenance and operation exceeds the

initial assumption, and whether it is due to reasons attributable to the administrator, etc. of the public facility, etc. or the appointed business, to study in advance how to share the responsibility in each case, and to agree on the agreement, etc. to the greatest extent possible.

(Reference)

- ① If, after the start of the provision of public services, facts occur that differ from the content and degree of environmental impact predicted in the procedures for environmental impact assessment, etc., and if there is a possibility of incurring substantial costs for repairing the public facility, etc., it is recommended to study the sharing of responsibilities in such cases beforehand, and to make arrangements in the agreement, etc., to the greatest extent possible.

#### 5. Risks at the Project Completion Stage

In the termination phase of the selected project, when the appointed business transfers the public facility, etc. to the administrator, etc. of the public facility, etc., the public facility, etc. may be removed and restored to its original state. In this case, even if the repair cost or removal/restoration cost at the termination of the project period of a long-term selected project is assumed as a specific amount in advance at the time of the conclusion of the agreement, etc., the actual cost may deviate from the required cost depending on the surrounding conditions of the public facility, etc., at the termination phase of the project, and the regulatory status pertaining to the removal, etc. Therefore, it is considered appropriate to agree on the procedures to secure the repair and removal/restoration costs before a certain period of time at the termination of the project in the agreement, etc.

(Reference)

- ① If the removal and restoration of the public facility, etc. is the business of the appointed business at the termination phase of the project, it is recommended to specify in the agreement, etc., the obligations of the appointed business included in the selected project prior to the dissolution and liquidation of the appointed business.
- ② There are cases where the public facility, etc. itself or the work product of the design of the public facility, etc. falls under the category of a copyrighted work as provided in Article 2, paragraph (1), item (i) of the Copyright Act (Act No. 8 of 1970). Therefore, it is recommended to specify in advance in the agreement, etc., how to deal with the rights of authors (moral rights and copyrights) as provided in the Copyright Act. When the appointed business commissions a third party to design the selected project, it is recommended that a separate agreement be reached between the parties to the agreement, etc. and the third party who has the rights of the author. In these cases, it is recommended to consider the timing of the transfer of ownership of the public facility, etc., and the expansion and renovation of the selected project during the project period.

## 6 Risks Commonly Associated with Each Phase

### (1) Force Majeure

Force majeure is a disorder that occurs from the outside regardless of the actions taken by the parties to the agreement, etc., and it cannot be prevented even if all the necessary precautions and preventive measures are taken. Force majeure events such as natural disasters cannot be attributed to either the administrator, etc. of the public facility, etc. or the appointed business that may damage temporary structures in the investigation stage and during the construction stage, and damage the facilities during the maintenance and operation stage. This can lead to interruptions and delays in each stage of the design, land acquisition, construction, maintenance and operation, as well as to raise the costs exceeding the agreed-upon amount. Therefore, it is recommended that the matter of how to share the additional expenditures and extend the project period should be studied in advance and contained in the agreement, etc. to the greatest extent possible.

### (Reference)

- ① The term “disasters, etc.” as defined in Article 2, paragraph (1), item (i) of the Basic Act on Disaster Management (Act No. 223 of 1961) is "damage resulting from a storm, tornado, heavy rainfall, heavy snowfall, flood, slope failure, mudflow, high tide, earthquake, tsunami, eruption, landslide, or other abnormal natural phenomena, or a large fire or explosion or other causes specified by Cabinet Order and similar to the above in the extent of damage they cause." Article 1 of the Order for Enforcement of the Act specifies that "the massive release of radioactive materials, sinking of a ship resulting in many victims or any other large-scale accidents" as the causes provided for by Cabinet Order. In some construction contracts used for ordinary public works projects, the term "disasters" are defined as "storms, torrential rains, floods, high tides, earthquakes, landslides, rockfalls, fires, disturbances, riots, and other natural or man-made events." In addition, it would be beneficial to study the effects of longer-than-normal rainfall or snowfall, avalanches, the discovery of buried cultural properties, unforeseen soft ground, and the release of toxic gases.
- ② In order to avoid disputes when additional expenditures are actually made based on the agreement, etc., it is recommended that the criteria for the content of natural disasters, the scope of coverage, the handling of compensation by insurance, etc., the handling of accumulated damage, and the procedures for notification and confirmation of damage be specified in advance in the agreement, etc. to the greatest extent possible.
- ③ In recent years, in addition to fire and earthquake insurance, weather insurance, etc. has been commercialized, and the range of possible risk mitigation has been expanding with the improvement of insurance and financial technologies. For this reason, it is recommended that a wide range of risk mitigation measures be studied at the appropriate time. It would be beneficial for the administrator, etc. of the public facility, etc. to provide in the agreement,



etc., that the appointed business should be required to present the insurance policy certificate, etc., at the time of insuring the facility.

- ④ In construction contracts used for ordinary public works, if any damage (except for damages caused by the contractor's negligence of its duty of care as a good manager and the portion covered by insurance as specified in the design documents) occurs to the subject construction work, etc. due to a natural disaster, etc. (limited to those that exceed the standard if specified in the design document) that cannot be attributed to either the ordering party or the contractor (hereinafter referred to as "force majeure") prior to the delivery of the construction work, there are some cases in which the ordering party shall bear an amount exceeding XX percent of the contract price of the work out of the total amount of damage and the cost of cleaning up the damage.

(2) Fluctuations in Prices, Interest Rates, Exchange Rates, Taxation Systems, etc.

Fluctuations in prices, interest rates, exchange rates, taxation systems, etc. may cause an increase or decrease in the costs and profits of the appointed business. Thus, it is recommended that the sharing of costs be studied in advance and agreed upon in the agreement, etc. to the greatest extent possible, taking into account the degree of impact from the fluctuations on the selected project.

(Reference)

- ① It is recommended that the parties to the agreement, etc. specify in advance the price levels, interest rates, exchange rates, etc. to be used as indicators in the agreement, etc., so that no dispute arises as to price fluctuations, etc., which may result in additional expenditures over the agreed upon expenses in the agreement, etc.
- ② Regarding the degree of impact on the selected project, it would be beneficial to study whether prices, interest rates, exchange rates, etc. have a significant impact on each of the major components of the cost (e.g., major construction material costs, labor costs, raw material and fuel costs for operation, etc.).
- ③ The private business may be able to mitigate the risk of interest rate fluctuations by purchasing interest rate swaps (exchange transactions between short-term floating interest rate and long-term fixed interest rate) or interest rate caps (capping transactions for short-term floating interest rate), and mitigate the risk of foreign exchange fluctuations by purchasing foreign exchange contracts (transactions to fix the future currency exchange rate at the present time) or currency options (transactions to purchase or sell the right to implement a future currency exchange rate at a certain level). It is necessary for the administrator, etc. of the public facility, etc. to note that, at present, there are considerable difficulties for private businesses to raise funds at fixed interest rates for a long period of

time exceeding 10-15 years, that there are restrictions on the size of the above transactions, and that conditions vary depending on the credit of the private business. It should also be noted that the effectiveness of risk mitigation measures may be impaired in the case of a long-term selected project, depending on the situation of the lending financial institutions, etc.

- ④ In the construction contract used for ordinary public works, if a request is made to change the contract price to reflect a change in the wage or price level after 12 months have passed from the date of conclusion of the contract, the ordering party shall bear the amount exceeding XX percent of the remaining contract price out of the difference between the remaining contract price (from the total contract price less the amount of the contract price of the completed work at the time of the request) and the remaining contract price after the change (calculated on the basis of wages or prices after the change). In addition, there are provisions for the case of sudden inflation that is not conditional on the passage of a certain period of time, and the case of a significant change in the price of major construction materials, although there is no change in the general level of wages or prices.

(3) Changes, etc. in Related Laws and Regulations such as Changes in Standards for the Installation and Management of the Public Facility, etc.

If the standards for the installation and management of the public facility, etc. are provided in laws and regulations, but the standards are changed, there may be interruptions or delays in the design, land acquisition, construction, maintenance and operation stages, or the costs required in each stage may exceed the agreed amount. Therefore, it is recommended to study in advance the measures that may be taken by the administrator, etc. of the public facility, etc. and the appointed business, and to provide them in the agreement, etc.

(4) Acquisition of Permits and Licenses, etc.

Delays in the completion or renewal of procedures specified by laws and regulations that must be completed before the start of construction or commencement of operation, changes in the content of the public facility, etc. as a result of the procedures, delays in the completion of negotiations, etc. with local parties that must be completed before the start of construction or commencement of operation, and changes in the contents of the public facility, etc. as a result of the negotiations, etc., may cause interruptions or delays in the design, land acquisition, construction, and maintenance and operation stages, and the costs required for each stage may exceed the agreed amount. Therefore, it is recommended to study in advance what procedures, etc. are required at what stage, whether the administrator, etc. of the public facility, etc. or the appointed business will be responsible for the procedures, etc., the delay, and the measures to be taken for changing the contents of the public

facility, etc., and to provide them in the agreement, etc.

### III. Other Points to be Noted

1. The selected project is expected to be a long-term project covering part or all of the design, land acquisition, construction, maintenance and operation. The administrator, etc. of the public facility, etc. shall respect the ingenuity and autonomy of the private business, consider minimizing the involvement of the private business, and study the risk allocation for the selected project, noting that it may be different from the risk allocation in contracts, etc. used in the provision, etc. of the public facility, etc. by the administrator, etc. of the public facility, etc. in the past. The risks differ for each selected project, and the content thereof should be evaluated and studied in accordance with the individual selected project. Some of the references given in II are examples of the division of labor in conventional public works, etc., and it should be noted that these are presented for the study material of the administrator, etc. of the public facility, etc. that intends to implement the PFI projects, and are not principles.
2. If the implementation policy formulated and publicized based on the Act indicates the basic concept of responsibility sharing, the expected risk and its sharing between the administrator, etc. of the public facility, etc. and the private business, it may be appropriate to change the risk allocation of the qualified project related to the implementation policy based on a reasonable competitive proposal by a private business. In light of the above, it is desirable to take into account the market research, etc., and if necessary, to elaborate or change the details by an appropriate time.

(Reference)

- ① At the time of formulation and publication of the implementation policy, the following costs may be incurred by each party, although it is not clear whether they are losses due to uncertain events whose possibility of occurrence cannot be predicted and whose effects cannot be assumed.
  - a. Expenses required for the application, etc. of non-selected private businesses through the process of call and selection, or the costs incurred by the administrator, etc. of the public facility, etc. for the implementation of process when no private businesses were selected.
  - b. If the appointed business is not able to conclude an agreement, etc., for any reason, the costs incurred to date by the appointed business, the private business who has newly established a corporation to act as the appointed business, and the administrator, etc. of the public facility, etc. For this reason, it may be beneficial for the private business to specify the cost items to be borne by the private business in the implementation policy, etc., if necessary.

3. When the appointed business is engaged in projects other than the selected project, the risks associated with the other projects may affect the provision of public services associated with the issues. In order to avoid or minimize this impact, it should be noted that necessary measures should be taken in consideration of economic rationality, such as establishing necessary provisions in the agreement, etc.

(Reference)

- ① Depending on the type of the selected project, and considering the economic rationality, several measures including having the newly established corporation implement the selected project and ensuring the independence of the business unit in terms of separate accounting can be taken. In cases where the appointed business is a newly established corporation and if it is to resolve concerns on the implementation of the selected project, it is recommended that in consideration of economic rationality, the administrator, etc. of the public facility, etc. and the investor of the appointed business agree on the necessary measures to ensure the proper and steady implementation of the selected project.
  - ② If the appointed business operates businesses other than the selected project with ancillary facilities such as private profit-making facilities, it is assumed that the risks associated with other projects may affect the provision of public services related to the selected project, and that damage to the public facility, etc. may affect ancillary facilities. For this reason, it is recommended that the risks associated with a selected project be separated from those associated with other projects to the greatest extent possible, and that measures, including the sharing of risks, be studied and provided in the agreement, etc., considering the degree of impact of the risks associated with other projects that may affect the selected project. Specifically, the following measures may be implemented in the business selection.
    - a. Support for the performance of other projects by the investors of the appointed business
    - b. Confirmation of creditworthiness of other businesses
    - c. Insurance coverage for the other businesses, etc.
4. If there is no payment from the administrator, etc. of the public facility, etc. to the appointed business until the completion of the construction of the public facility, etc. by the appointed business, and the payment to the appointed business as service charge etc. starts after the commencement of operation, it is recommended that the administrator, etc. of the public facility, etc. shall consider that depending on the scale of the selected project, the appointed business may need to raise a considerable amount of private capital, study in advance the actions to be taken by the appointed business and the administrator, etc. of the public facility, etc. if it is recognized that financing is likely to be difficult or becomes difficult, and provide this in the agreement, etc., as specifically and explicitly as possible.

5. The administrator, etc. of the public facility, etc. shall, while minimizing the involvement of the appointed business, agree in advance on reporting the implementation status of the selected project in the agreement etc., to promptly recognize the materialization or potential materialization of risks agreed to be shared in advance in the agreement, etc.

#### Supplementary Provisions

These guidelines shall come into effect as from October 23, 2018.