

Contract Guidelines

— Key Points on PFI Project Contracts —

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The following laws and regulations, etc. are cited in the *Contract Guidelines — Key Points on PFI Project Contracts*.

Laws

- Act on Promotion of Private Finance Initiative (Act No.117 of 1999): hereinafter, **PFI Act**
- Local Autonomy Act (Act No. 67 of 1947)
- State Redress Act (Act No. 125 of 1947)
- Act on Access to Information Held by Administrative Organs (Act No. 256 of 1949): hereinafter, **Act on Access to Information**
- Public Accounting Act (Act No. 35 of 1947)
- Act for Promoting Proper Tendering and Contracting for Public Works (Act No. 127 of 2000): hereinafter, **Proper Tendering and Contracting Act**
- Act on Guaranty Service Related to Advance Payment of Public Works (Act No. 184 of 1952)
- Act on Prevention of Delay in Payment under Government Contracts, etc. (Act No. 256 of 1949): hereinafter, **Act on Prevention of Delay in Payment**
- National Government Asset Act (Act No. 73 of 1948)
- Act on Management, etc. of Claims Held by the State and Other Matters (Act No. 114 of 1956)
- Building Standards Act (Act No. 201 of 1950)
- Housing Quality Assurance Act (Act No. 81 of 1999)
- Civil Code (Act No. 89 of 1896)
- Companies Act (Act No. 86 of 2005)
- Construction Business Act (Act No. 100 of 1949)
- Act on Architects and Building Engineers (Act No. 202 of 1950)

Cabinet orders

- Enforcement Order of the Act on Promotion of Private Finance Initiative (Cabinet Order No. 279 of 1999): hereinafter, **PFI Enforcement Order**
- Order for Enforcement of the Local Autonomy Act (Cabinet Order No. 16 of 1947)
- Cabinet Order on Budgets, the Settlement of Accounts, and Accounting (Imperial Order No. 165 of 1947): hereinafter, **Cabinet Order on Budgets**
- Order for Enforcement of the Act on Management of Claims Held by the State and Other Matters (Cabinet Order No. 337 of 1956)
- Order for Enforcement of the Construction Business Act (Cabinet Order No. 273 of 1956)

Other

- Basic Policy on the Implementation of Projects on the Private Finance Initiative (Cabinet Decision of October 23, 2018): hereinafter, **Basic Policy**

- Guidelines on Risk Allocation, etc. in PFI Projects (October 23, 2018): hereinafter, **Risk Guidelines**
- Guideline for Monitoring (October 23, 2018)
- Standard Terms of Contract for Public Works (Created by Central Council for Construction Business on February 21, 1950; lastly amended on December 13, 2019): hereinafter, **Standard Contract Terms**
- Contract Management Regulations (Ministry of Finance Order No. 52 of 1962)
- Partial Revision of Interest Rate for Delay in Payment under the Government Contracts (Ministry of Finance Announcement No. 54 of 2014)
- Partial Revision of Rate Specified by the Minister of Finance Prescribed in the Main Clause of Article 29, paragraph (1) and Article 37, paragraph (1) of the Order for Enforcement of the Act on Management of Claims Held by the State and Other Matters (Ministry of Finance Announcement No. 129 of 2003)

The definitions of terms used in the *Contract Guidelines — Key Points on PFI Project Contracts* are as follows, and unless otherwise specified, the definitions in the PFI Act and Basic Policy shall be follow.

Consortium member company: A constituent company of the joint venture (hereinafter, consortium) formed for a private business which becomes the successful bidder of the selected project. (It funds the establishment of the appointed business and may also be entrusted with or contracted for work pertaining to the selected project by the appointed business.)

Entrusted/contracting company: A company entrusted with or contracted for work pertaining to the selected project by the appointed business (other than consortium member companies).

Design company: A consortium member company or entrusted/contracting company in charge of design.

Construction company: A consortium member company or entrusted/contracting company in charge of construction work.

Maintenance and operation company: A consortium member company or entrusted/contracting company in charge of maintenance and operation.

Subcontracting company: A company entrusted with or contracted for work pertaining to the selected project by a consortium member company or entrusted/contracting company.

Service consideration: A specific amount of money paid by the administrator, etc. to the appointed business for design, construction, maintenance, and operation of the facility, on the condition that the appointed business properly implements work in accordance with the PFI project contract, bid instructions, etc., and its bid proposal.

Construction costs: Design costs, construction supervision costs, construction costs, equipment installation costs, interest during construction, etc.

Maintenance and operation costs: Outsourcing cost, repair cost, labor cost, purchase cost, etc.

BOT scheme: Abbreviation of Build, Operate and Transfer. A project delivery method in which a private business builds, maintains, and operates a facility, and transfers the ownership of the facility to the administrator, etc. after the completion of the project.

BTO scheme: Abbreviation of Build, Transfer and Operate. A project delivery method in which a private business builds a facility, transfers its ownership to the administrator, etc. after the facility is completed, and maintains and operates it.

Preface

The *Contract Guidelines — Key Points on PFI Project Contracts* (hereinafter, Guidelines) explain the outline, purpose, applicable laws and regulations, and key points by items provided for in most PFI project contracts, based on Japanese PFI project contract, etc. disclosed to date, as one of the practical indicator for preparing a project contract, direct agreement, and basic agreement pursuant to Article 5, paragraph (2), item (v) of the PFI Act. 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) and the Basic Policy on the Implementation of Projects on the Private Finance Initiative (Cabinet Decision of October 23, 2018), and in line with these guidelines. The guidelines can also serve as a reference in PFI projects implemented by persons other than the national government.

The guidelines do not prevent each ministry and agency from devising methods according to the situation in accordance with the Act and the Basic Policy for the smooth implementation of PFI projects, and implementing of the PFI projects by methods other than those indicated in the guidelines.

For convenience of reference by those other than the national government, laws and regulations that apply to PFI projects implemented by those other than the national government are indicated in the footnote.

The guidelines are generally structured according to a PFI project contract which is chronologically organized by work that the administrator, etc. of the public facility, etc. (hereinafter, the administrator, etc.) defined in Article 2, paragraph (3) of the PFI Act entrusts to the appointed business defined in Article 2, paragraph (5) of the same Act.

Various project schemes are possible for the PFI projects. Explanation in the guidelines assumes the following:

- (1) The PFI projects adopts performance-based ordering, and the appointed business is selected in a comprehensive evaluation of an open competitive bidding or by competitive discretionary contract depending on the project;
- (2) The consortium involved in the implementation of the selected project will become the successful bidder;
- (3) The consortium member companies, etc. provide funds and establish a new corporation, which becomes the appointed business (however, if the administrator, etc. does not require all consortium member companies to provide funds in the bid instructions, etc., the consortium member companies may not provide funds. This needs to be clarified by the administrator, etc. in the bid instructions, etc.). It is necessary to note that a legal personality other than a corporation may be used in some project schemes;
- (4) The appointed business does not carry out projects other than the selected project;
- (5) The land owned by the administrator, etc. is leased to the appointed business for purpose of the selected project;
- (6) The appointed business provides a public service by designing, building, maintaining, and operating a facility (the selected project mainly involves design, construction, and maintenance of

a facility; the Guidelines do not explain cases where operation of the facility accounts for a major part of the selected project);

- (7) The selected project is mainly funded through project finance by a lending financial institution, etc. However, it is necessary to note that other financing methods are not precluded;

* Project finance is a method of financing a specific project in which repayment of finance and interest is made using cash flows (profits) generated by the project, with the project assets pledged as security for the financing.

- (8) The project funds are recovered by the service consideration, etc. paid by the administrator, etc.

The above supposition has been made for the necessity of specifying to a certain extent the project scheme on which explanation of the PFI project contract is based, and it does not mean that such a project scheme is better than other schemes in all aspects when implementing a PFI project. For convenience of explanation, some of the possible project schemes and provisions of the Standard Terms of Contract for Public Works are also presented for comparison in the Guidelines. The administrator, etc. needs to determine the most appropriate project scheme, provisions of the PFI project contract, stance on transfer of shares, etc. based on the content, scale, local characteristics, etc. of the project while referring to the Guidelines. In particular, in case of a selected project that focuses on operation of a facility (selected projects including operation of a hospital, etc.), it must be noted that depending on the purpose of establishment of the facility and the details of its operation, individual considerations are necessary.

A PFI project contract is usually long-term compared to general contracts for public works and involves numerous parties such as the appointed business, consortium member companies, entrusted/contracting companies, and the lending financial institution, etc. It is a contract that constitutes the core of a PFI project and directly impacts not only the appointed business, which is a party to the PFI project contract, but also other parties such as consortium member companies, the entrusted/contracting companies, and the lending financial institution, etc. The administrator, etc. needs to consider provisions of the PFI project contract that will allow a continuous and stable provision, etc. of public service, while paying attention to its impact on the related parties from the viewpoint of ensuring stability of the contractual relationship pertaining to the PFI project.

The Guidelines have been created based on the Japanese PFI project contracts, etc. disclosed to date, and it must be noted that provisions of PFI project contracts may undergo various changes, etc. due to diverse projects and changes in Japan's economic and social environment. In particular, PFI projects involving collection of usage fees (operation of a public facility, etc.) 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. The contract for implementing the operating right of public facility shall be concluded based on the *Guidelines on the Right to Operate the Public Facility, etc. and the Public Facility, etc., Operating Project*.

Parties related to the selected project, such as the administrator, etc., appointed business, consortium member companies, entrusted/contracting companies, and lending financial institution, etc., are supposed to have the following contractual relationships.

1 PFI project contract

- A contract concluded between the administrator, etc. and the appointed business. It provides that the appointed business shall have the obligation to provide the administrator, etc. with the public service that meets the standards required by the administrator, etc. by implementing and financing the design, construction, maintenance, and operation of the facility pertaining to the selected project, and the administrator, etc. shall have the obligation to make payment to the appointed business for the public services it has provided. It is called a "project contract" in Article 5, paragraph (2), item (v) of the PFI Act and the Basic Policy.

2 Basic agreement

- The basic agreement confirms the consortium as the successful bidder. It defines the necessary matters regarding the obligations of the administrator, etc. and the consortium in this agreement which is concluded between the administrator, etc. and the consortium member companies. It provides for the establishment of a corporation, which becomes the appointed business, by the consortium member companies and how to handle the preparatory actions of the selected project.

3 Direct agreement

- It is a direct agreement between the administrator and the lending financial institution, etc. When it becomes difficult for the appointed business to carry out the selected business, the lending financial institution, etc. reserves the exercise of right to request to cancel the PFI business contract to the administrator, etc. for a certain period of time. The agreement provides the necessary items to enable a certain level of intervention (Step-in) by the lending financial institution, etc. in the selected business, including consents on the obligations between the administrator, etc. and the selected business to serve mutual notifications in the event of non-achievement of the required levels or loss of the benefit of time (*), and to establish security interests for shares issued by the selected businesses and assets held by them.

*The benefit of time is a benefit that a contract party enjoys by the fact that the performance of obligations is not claimed until a specific time is reached. The benefit of time is granted to the debtor because the creditor grants the debtor a grace for repayment on the basis of trust; therefore, a special provision may provide that, when the debtor acts in a way that damages the relationship of trust, the creditor may claim forfeiture of the benefit of time and demand immediate repayment of debt.

4 Project-related agreement (outsourcing contract, contract for work, etc.)

- An agreement concluded between the appointed business and a consortium member company or entrusted/contracting company when the appointed business entrusts a third-party consortium member company or entrusted/contracting company with or contracts to implement the design, construction, maintenance, and operation of the facility and provide public service in accordance with the PFI project contract. Also, an agreement concluded between the consortium member company or

entrusted/contracting company and a subcontracting company when the former company entrusts with or contracts a subcontracting company for these works.

5 Loan agreement

- An agreement concluded between the lending financial institution, etc. and the appointed business when the lending financial institution, etc. provides a loan to the appointed business. It mainly provides for agreements on the loan, the purpose of the loan, the loan procedure, the loan prerequisites, repayment of the principal, payment of interest, payment of damages for delays, the repayment allocation method, representations and warranties, the borrower's oath, and grounds for forfeiture of the benefit of time, etc.

6 Security-related agreement

- An agreement aimed at allowing the lending financial institution, etc. to obtain security interests in the assets and rights pertaining to the selected project. Creation of these security interests is intended not for recovery of the loan by selling the collateral but by continuing the selected project in order to restore it. It aims to eliminate interference of a third party and securely recover the loan through smooth and continuous implementation of the project by allowing the financial institution, etc. to have priority over other creditors, etc. and making other creditors lose the benefit of seizing assets, etc. of the selected project. The collateral may include the rights of the appointed business under the PFI project contract, shares issued by the appointed business, and project assets.

7 Creditor agreement

- An agreement concluded between the creditors when multiple lending financial institution, etc. form a lending organization. It provides for basic rights and obligations between the creditors such as the method of decision-making for the exercise of rights as creditors of the lending organization and the method of claiming the security interests. If concluded between priority lenders only, when funders make a subordinated loan, or when the appointed business enters into an interest rate swap (*) for the loan, an agreement between the priority lenders or an agreement may be concluded between creditors including the funders and other parties to swap the interest rate.

*An interest rate swap is a financial method in which the funding based on a floating interest rate is essentially exchanged for funding based on a fixed interest rate. It allows the appointed business that pays interest at a floating interest rate to enjoy the same effect as when paying interest at a fixed interest rate by concluding a contract that it makes payment to the financial institution at a fixed interest rate in exchange for receiving a floating rate.

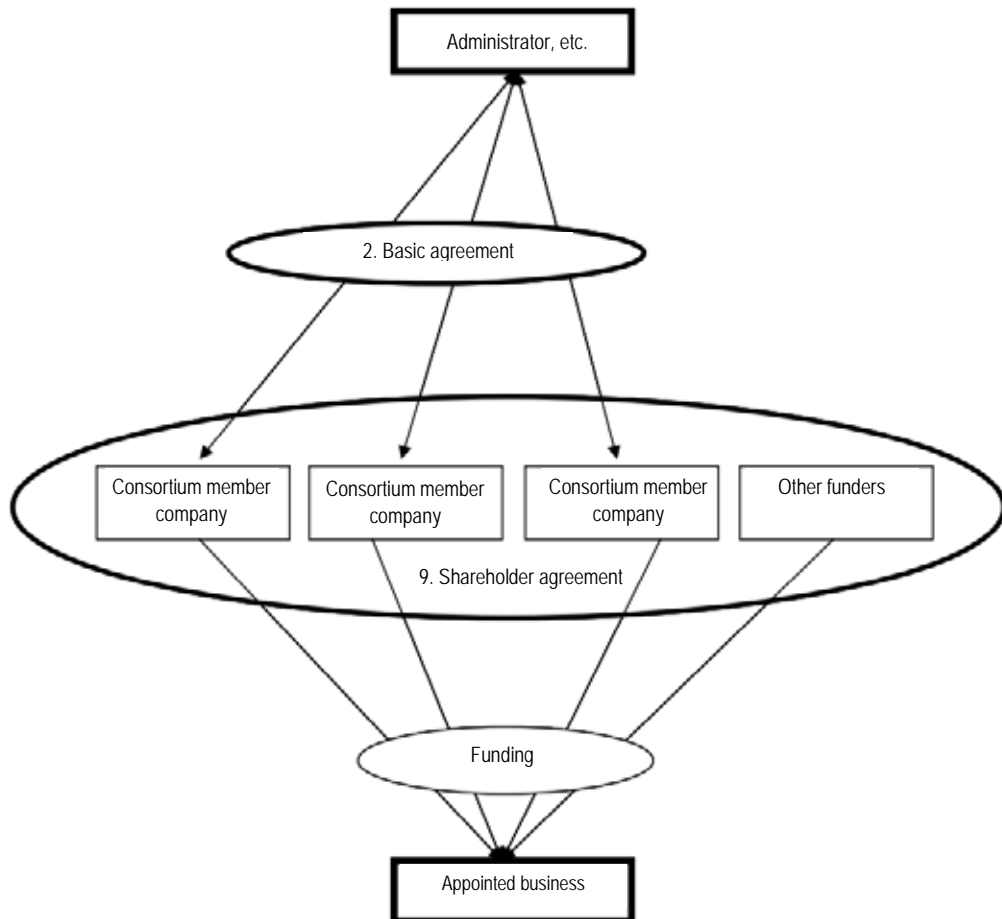
8 Funding support agreement

- This is an agreement concluded between the lending financial institution, etc. and the funders (consortium member companies) that become the shareholders of the appointed business. It mainly provides for the obligation of funders to provide additional funds (equity investment or subordinated loan) and the obligation to support and cooperate with the appointed business, etc.

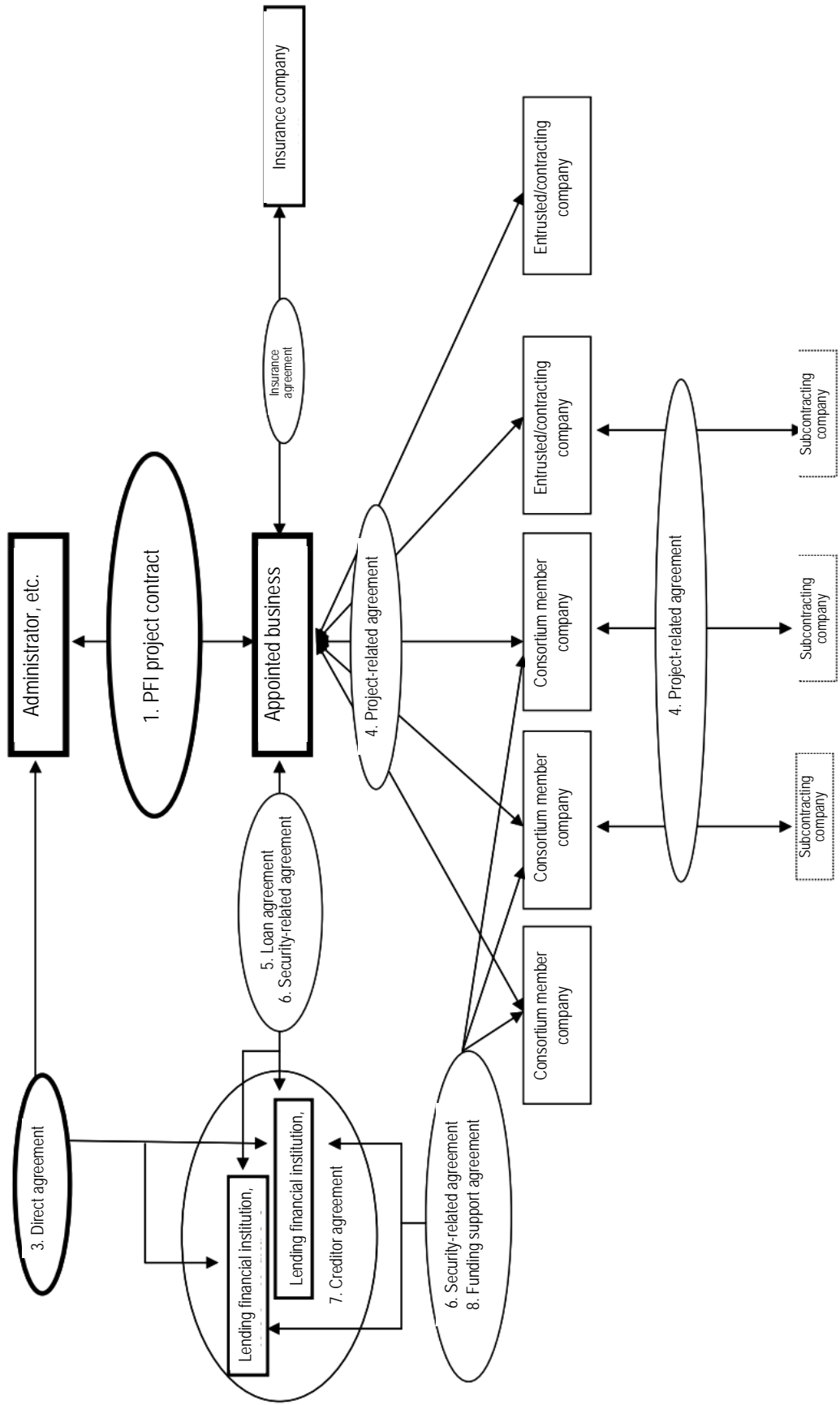
9 Shareholder agreement

- This is an agreement concluded between the shareholders of the appointed business (consortium member companies and other funders) to specify basic terms of agreement such as the allocation of responsibilities regarding operation of the corporation or the selected project. It mainly provides for the investment ratio of the shareholders, the purpose of establishment of the corporation and details of its business, restrictions on disposition such as transfer of shares, allocation of work between shareholders, and allocation of subordinated loan between shareholders.

Example of contractual relationship (under basic agreement)



Example of contractual relationship (under PFI project contract)



1. Matters Relating to the Whole Project

1. Outline

- Provide for matters relating to the whole contract, such as the purpose of the contract, definitions of terms used in the contract, governing laws, project outline, project schedule, and application of contract documents, etc.
2. Points to be noted regarding laws and regulations relating to the preparation of a PFI project contract
- Article 14, paragraph (1) of the PFI Act provides that "a selected project is to be carried out in accordance with its project contract (which means, if the right to operate the public facility, etc. is established pursuant to the provisions of Article 16, the agreement on the operation rights of a public facility, etc. pertaining to the right to operate the public facility, etc. (which means the agreement on the operation rights of a public facility, etc., provided in Article 22, paragraph (1)); the same applies in the following paragraph) pursuant to the basic policy and the relevant implementation policy." The Basic Policy also provides that it is "indispensable to clarify in writing the content of the contract, such as the roles of the contract parties and allocation of responsibilities, regarding the agreement between the administrator, etc. of the public facility, etc. and the appointed business (contract principles)" (Preamble of the Basic Policy).
 - The Public Accounting Act provides that a contract officer, etc. shall prepare a written contract that includes the particulars of the purpose of the contract, the contract price, performance period, and contract guarantee, and other necessary particulars pursuant to the provisions of the Cabinet Order (Article 29-8, paragraph (1) of the Public Accounting Act and Article 100 of the Cabinet Order on Budgets).
 - When the administrator, etc. prepares a contract based on the PFI project contract, the contract does not become final and binding until the names and seals of both the contract officer, etc. and the appointed business have been affixed to the written contract pursuant to the provisions of the Public Accounting Act (Article 29-8, paragraph (2) of the Public Accounting Act).¹

¹ When a local government is the administrator, etc., similar provisions of Article 234, paragraph (5) of the Local Autonomy Act apply.

1-1 Purpose of the Contract

1. Outline

- Provide that the purpose of the contract shall be to set forth all matters necessary for the mutual cooperation between the administrator, etc. and the appointed business, and to the smooth implementation of the selected project.

2. Purpose

- The description of the purpose of the contract does not provide for the rights and obligations of the contract parties, but it aims to confirm the premise of conclusion of the contract by the contract parties.

3. Provisions of applicable laws and regulations

- The Public Accounting Act provides that a contract must include particulars of the purpose of the contract (Article 29-8, paragraph (1) of the Public Accounting Act).

1-2 Respect of the Purpose of the Project

1. Outline

- For the purpose of confirmation, provide that the appointed business shall fully understand the public nature of the selected project and respect the purpose of implementing the selected project and that the administrator, etc. shall fully understand that the selected project is to be implemented by the appointed business, which is a private business, and respect the purpose.

2. Purpose

- The Basic Policy provides that a PFI project aims at “efficiently and effectively implementing (principles of efficiency) a project of public nature (principles of public nature) through utilization of private finance, management abilities and technical capabilities, (principles of utilizing private sector resources) and respecting the autonomy and ingenuity of private businesses" (Preamble of the Basic Policy). This provision is in line with this purpose.

1-3 Contract Period

1. Outline¹

- Provide that the contract period shall start on the date of execution of the contract on which the contract comes into effect, and end on a specific date or after a certain period following the start of use of the facility.

2. Provisions of applicable laws and regulations

- The Public Accounting Act and the Cabinet Order on Budgets provide that a contract must include particulars of the performance period (Article 29-8, paragraph (1) of the Public Accounting Act and Article 100 of the Cabinet Order on Budgets).
- The Act on Prevention of Delay in Payment also has similar provisions (Article 4, item (ii) of the Act on Prevention of Delay in Payment).²

¹ When a local government concludes a PFI project contract under which the price for the purchase or borrowing of a public facility, etc. among the scheduled contract price exceeds 500 million yen in case of a prefecture, 300 million yen in case of a designated city, 150 million yen in case of a non-designated city, and 50 million yen in case of a town or village, a resolution by its local council must be obtained in advance (Article 12 of the PFI Act and Article 3 of the PFI Act Enforcement Order).

² When a local government is the administrator, etc., provisions of Article 14 of the Act on Prevention of Delay in Payment shall apply *mutatis mutandis*.

1-4 Project Schedule

1. Outline

- Clarify important dates regarding the implementation of the selected project (i.e. the design start date, construction start date, construction completion and operational structure confirmation date, scheduled delivery date, maintenance and operation start date, maintenance and operation end date, pre-transfer inspection and facility transfer date, etc.) as a project schedule, and provide that the appointed business shall have the obligation to implement the selected project accordingly.

2. Purpose

- The provision of the project schedule clarifies the performance period of each phase of the selected project and aims at establishing the base time when the rights and obligations of the contract parties arise in cases such as the case where additional costs are incurred due to the schedule management by the administrator, etc. or delay in the performance. Since the non-respect of important dates may be a ground for cancellation of the PFI project contract in some cases, it is necessary to pay attention to its relation with the grounds for cancellation. However, it may not be always appropriate to obligate the appointed business to perform design, construction works, maintenance, and operation according to a detailed project schedule, except for clear base times under the PFI project contract (i.e. completion of the facility, delivery (or start of operation) of the facility). It must be noted that, if the administrator, etc. obligates the appointed business to strictly follow dates that are not necessarily important, the costs required for fulfilling such obligation may be reflected in the contract price.
- The Risk Guidelines provide that "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" and "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. (omitted) to request detailed reports, or give instructions." (Risk Guidelines II-1 (2) (Reference) (1)).

3. Provisions of applicable laws and regulations

- The Public Accounting Act provides that a contract must include particulars of the performance period (Article 29-8, paragraph (1) of the Public Accounting Act).
The Act on Prevention of Delay in Payment also provides that a government contract must include particulars of the timing of completion of performance (Article 4 of the Act on Prevention of Delay in Payment).

1-5 Project Outline

1. Outline

- Provide for the outline of the selected project which the appointed business has the obligation to implement in accordance with the PFI project contract, etc., for confirmation by the contract parties.
- In case of a selected project under BTO scheme, provide for the outline of the project such as the design and construction work of the facility, transfer of the facility to the administrator, etc., maintenance and operation of the facility, and funding for implementation of the project.

2. Details of the project

- The project outline contains technical information and is often indicated on an appendix to the PFI project contract. Details of the project including the required business level set by the administrator, etc. also contain technical information and are usually compiled as documents attached to the PFI project contract. (Related: 1-6 Application of provisions)

3. Provisions of applicable laws and regulations

- The Act on Prevention of Delay in Payment provides that a government contract must include particulars of the details of performance (Article 4 of the Act on Prevention of Delay in Payment).
- Under the PFI Act, the project implemented by the selected private business is the provision etc., of the public facility, etc. which has been determined to be implemented by the private business in the project contract pursuant to Article 5, paragraph (2), item (v) of the PFI Act. Therefore, it is necessary to specify the details, etc. of the selected project to be implemented by the appointed business in the PFI project contract, etc. (Article 8, paragraph (2) of the PFI Act).

1-6 Application of Provisions

1. Outline

- Provide for the application of various provisions of the PFI project contract, etc. pertaining to the selected project.
- On the premise that the appointed business implements the selected project in accordance with the PFI project contract, bid instructions, etc., and bid proposal, provide for the application of these documents in case there are inconsistencies between them.

2. Purpose

- In a PFI project, the content of the selected project is complemented specifically and in detail by the bid instructions, etc. presented by the administrator, etc. at the time of the call of private businesses, the bid proposal submitted by the appointed business to the administrator, etc., the PFI project contract, and the design drawings prepared by the appointed business in accordance with the PFI project contract, etc., in this order. Therefore, it is desirable to provide for the application of these documents in the PFI project contract in case there are inconsistencies between them.

3. Application

- If there are inconsistencies between the PFI project contract, bid instructions, etc., and bid proposals, it is common practice that the PFI project contract, bid instructions, etc., and bid proposals are prioritized and applied in this order.
- As for the application of the required level documents in the bid proposal and bid instructions, etc., by providing that the bid proposal applies with priority only when the service standards proposed therein exceed those in the bid instructions, etc., it is possible to secure the higher standards for matters with inconsistencies between the service standards indicated by the administrator, etc. in the bid instructions, etc. and those proposed by the appointed business.

The Q&A document in the bid instructions, etc. is considered to be part of the bid instructions, etc.

1-7 Funding by the Appointed Business

1. Outline

- Provide for the obligation of the appointed business to procure funds. When providing for the obligation of the appointed business to make efforts for application of fiscal or financial support for the selected project, it is also possible to provide for the obligation of the administrator, etc. to cooperate for the related procedures.

2. Purpose

- In a PFI project, unlike in a general contract for public work, risks of funding required for implementation of the selected project, such as the construction work of the facility, are borne by the appointed business. Since the service consideration is usually levelled and paid by the administrator, etc. after the provision of public service starts, the appointed business should normally procure funds required for the provision of public service, including the design, construction, maintenance, and operation of the facility, at its own responsibility.
- A general contract for public work provides that the contractor may demand advance payment from the orderer by concluding a guarantee contract with a guarantee business prescribed in Article 2, paragraph (4) of the Act on Guaranty Service Related to Advance Payment of Public Works (Article 35, paragraph (1) of the Standard Contract Terms); that the contractor may demand partial payment for the completed portion and certain construction materials (Article 38 of the Standard Contract Terms); and that after the facility passes the completion inspections, the orderer shall pay remainder of the contract fee within 40 days from the date the contractor demands for the payment (Article 33 of the Standard Contract Terms). As for the costs incurred during the construction work, the contractor may also demand partial payment of the amount equivalent to the completed portion before completion of the construction work (Article 38 of the Standard Contract Terms). Therefore, the burden on the contractor is limited.
- Since a PFI project uses private funds, the appointed business should normally procure funds for all costs pertaining to the implementation of the selected project by its own responsibility. However, the administrator, etc. needs to strive to set appropriate and clear provisions, taking into account that measures taken by both parties to the contract have a large impact on the amount, period, costs, and other conditions of funding.

3. Stance on funding

(1) Funding method

- When the appointed business is a corporation newly established for the selected business, it usually funds the selected project through investments or by subordinated loans from the consortium member companies, etc. and from the financial institutions, etc. Funding methods are expected to diversify in

the future. The administrator, etc. needs to note that the capital ratio of the appointed business may affect the project costs of the appointed business and eventually the contract price.

- In particular, the administrator, etc. needs to pay attention to the proportion of investments from consortium member companies, which affects the payment of the principal and interest of loans by the appointed business and plays a role of securing a certain interest or involvement in the selected project.
- When the appointed business procures funds from a financial institution, etc. by project finance, the financial institution, etc. normally makes a loan in which the principal and interest are paid from cash flows generated in the selected project, and secures it against assets pertaining to the selected project. However, even if the lending financial institution, etc. has a security interest in the assets pertaining to the selected project, it is often difficult to recover the loan by disposing of them by sale. Therefore, financial institutions, etc. often make the stability of cash flows of the appointed business an important condition for giving out a loan, and put a particular focus on the content of the PFI project contract, etc. in particular the provisions regarding the service consideration payment mechanism and measures taken by the administrator, etc. when the selected project stagnates.
- In addition to the payment of the service consideration, financial institutions, etc. also place importance to the payment period and method when the administrator, etc. bears additional costs incurred under the PFI project contract, from the viewpoint of ensuring the stability of cash flows. When the appointed business does not have surplus funds and there is no sufficient system to cover the lacking funds, if the administrator, etc. does not pay the additional costs in a timely manner, the appointed business may fall short of funds, and the overall operation of the selected project may be hindered. At the same time, it is necessary to note that the period and method of payment of additional costs by the administrator, etc. are automatically based on the budgetary provisions.
- Structuring of project finance requires a considerable amount of time. Therefore, the administrator, etc. needs to strive to allow sufficient time for coordination between the related parties, from the public tendering of the appointed business to conclusion of various contracts relating to structuring of project finance.

(2) Fixed interest rate

- To level the fiscal spending, the administrator, etc. often fixes the price equivalent to the borrowing interest, paid to the appointed business, for a certain period. In this case, the appointed business usually procures funds at a fixed interest rate to avoid fluctuations in its amount of the borrowing interest due to fluctuations in the borrowing interest rate level during the project period.
- When determining the amount equivalent to the interest in the price paid to the appointed business, the administrator, etc. needs to note that (1) the lending financial institution, etc. needs to sufficiently examine the content of the PFI project contract to determine the possibility of a loan to the appointed business and the loan conditions (lending interest rate level, redemption conditions, etc.) and (2) the period of funding at a fixed interest rate to the appointed business is constrained by the market. It is also necessary to note that the date the lending interest rate is determined by the lending financial

institution, etc. is the date the loan is executed, and the lending interest rate is determined based on the financial market trend (and also when the interest rate is fixed by interest rate swap).

- The amount equivalent to the borrowing interest paid by the administrator, etc. to the appointed business is determined based on the lending interest rate of the lending financial institution, etc. The date of start of interest is determined by the lending financial institution, etc. is the date the loan is executed, such as the facility delivery date, which is usually after a considerable time has passed since the conclusion of the PFI project contract. As the market interest rate changes daily, on the date of concluding the PFI project contract, it is difficult for the appointed business to accurately estimate the lending interest rate to be set. However, if the price equivalent to the borrowing interest paid by the administrator, etc. to the appointed business is fixed on the date of concluding the PFI project contract, the appointed business has no choice but to estimate the lending interest rate at that time. Due to this, the actual lending interest rate set by the lending financial institution, etc. will vary from the rate estimated by the appointed business. If the interest rate rises, there is a risk that the funding costs increases due to the fact that the appointed business must bear the differences in the interest, which may be reflected in the contract price. In some cases, the administrator, etc. bears the risk of interest rate fluctuations during that period, and the amount of the borrowing interest paid by the administrator, etc. to the appointed business is determined on a specific date after the date of conclusion of the PFI project contract (base date) which is scheduled as closely as possible to the date the lending interest rate is determined by the lending financial institution, etc.

(3) Letter of intent

In a public tender, the administrator, etc. may obligate the bidders to submit a letter of intent from a financial institution, etc. As the financial institutions, etc. do not have information necessary for risk analysis and contract negotiation, etc. for the structuring of project finance in the stage of proposal submission by the bidders, the letter of intent does not promise a loan. Therefore, it is necessary to note that the submission of a letter of intent does not guarantee a loan.

4. Subsidies and other support measures

- When providing for the obligation for the appointed business to apply for fiscal or financial support measures for the selected project, it is also possible to provide for the obligation of the administrator, etc. to cooperate.
- The administrator, etc. should set forth the allocation of risks relating to the grant of applicable subsidies, etc., or interest-free or low-interest loans from the public financial institutions, etc. in the bid instructions, etc. as a prerequisite for proposal by the private businesses, in order to determine the conditions for competition between the bidders.
- In the bid instructions, etc., the administrator, etc. should also set forth how the reduction in the financial costs is reflected in the service consideration when support measures such as subsidies

become available between the open invitation for participation of private business and the conclusion of the PFI project contract.

- When the appointed business changes the amount to be borrowed from the lending financial institution, etc. depending on the availability of subsidies and other support measures, it is necessary to note the following points:
 - (1) If the borrowing amount increases, there will be inconsistencies in the funding plan on which the lending financial institution, etc. had initially based the credit decisions, and so, it needs to make credit decisions again. This may take time and even make securing the loan difficult in some cases.
 - (2) When the borrowing amount is changed after the loan is executed, there will be additional costs (loan cancellation fees, interest rate swap cancellation fees, etc.).
 - Taking into account that the availability of public support measures may not be determined by the time of bid proposal submission by private businesses, the administrator, etc. should consider appropriate allocation of risks (measures for additional costs and delay in procurement of funds incurred by the appointed business) in advance and set them forth in the bid instructions, etc.
5. Application of tax laws and regulations
- Application of tax laws and regulations to the selected project may not be clear during the open invitation for participation. In such a case, and when it is found appropriate to establish tax-related conditions for competition between the bidders, the administrator, etc. needs to present certain assumptions about tax laws and regulations so that all bidders can make a proposal based on a common interpretation of their application, although the final interpretation is made by the tax authority. On the cost sharing between parties, in case where the assumption is unproved, the administrator, etc. may also consider in advance and take measures such as clearly stating it in the bid instructions, etc. so as to avoid messing with it.

1–8 Leasing of State-owned Land

1. Outline

- Provide that the national government, which is the administrator, etc., shall lease the state-owned land to the appointed business during the project period.

2. Land lease¹

- A contract for leasing of land from the administrator, etc. to the appointed business is usually concluded separately from the PFI project contract. The land lease may provide the following:
 - 1) that the use of the leased land is limited to the scope of performance of the selected project;
 - 2) the land lease period;
 - 3) the leasing fee and the amount of the land lease right when the land is leased for a price;
 - 4) the prohibition of transfer, etc. of rights pertaining to the land by the appointed business without approval of the administrator, etc.;
 - 5) the obligation of the appointed business to maintain the leased land with the due care of a prudent manager (Article 400 of the Civil Code);
 - 6) the land lease ends at the same time as the PFI project contract ends or when the PFI project contract is cancelled, etc.

3. Laws and regulations relating to the use of land

(1) Price for using the state-owned land

- Pursuant to provisions of Article 71 of the PFI Act, when the national government, which is the administrator, etc., finds it necessary, it may allow the appointed business to use the state-owned land without charge or for a price lower than the market value during the selected project.² When this contract for leasing is concluded between the administrator, etc., and appointed business separately from the PFI project contract, in case the PFI project contract is cancelled, it will also be cancelled because the appointed business loses its status.

(2) Leasing of land which is an administrative asset

- Establishment of private rights on the administrative assets is restricted under the National Government Asset Act. However, pursuant to provisions of Article 69 of the PFI Act, when the administrator, etc. finds it necessary, it may lease such lands to the appointed business within a scope that does not hinder the uses or purpose of such leasing (unless otherwise provided in other laws).

(3) Leasing of land which is an ordinary asset

¹ When a local government is the administrator, etc., leasing of an asset without a proper price for it must be resolved by a local council pursuant to provisions of Article 96, paragraph (1), item (vi) of the Local Autonomy Act, except for cases prescribed in municipal ordinances.

² When a local government is the administrator, etc., provisions of Article 237, paragraph (2) of the Local Autonomy Act apply.

- Establishment of private rights for ordinary assets is allowed under the National Government Asset Act, and the administrator, etc. may lease land which is an ordinary asset to the appointed business (Article 20 of the National Government Asset Act).¹ However, its leasing period must not exceed 30 years (Article 21, paragraph (1), item (iii) of the National Government Asset Act).

(4) Provisions of the Civil Code

- When state-owned land which is an administrative or ordinary asset is leased to the appointed business, leasing of the land is subject to the Civil Code, and leasing for a price will be based on a lease (Article 601 of the Civil Code), and leasing without charge will be based on a loan for use (Article 593 of the Civil Code).

¹ When a local government is the administrator, etc., provisions of Article 238-5 of the Local Autonomy Act shall apply.

1-9 Obtaining of Permission and Authorization

1. Outline

- Provide that the appointed business shall have the obligation to obtain permission and authorization, etc. required for implementation of the selected project, and the administrator, etc. shall have the obligation for reciprocity.

2. Allocation of responsibilities for obtaining permission and authorization

- Provide that the appointed business is responsible to obtain permission and obliged to bear the costs. The appointed business shall be held responsible when it does not perform its obligations under the PFI project contract on the ground that it failed to obtain a part of permission required. Specifically, the appointed business shall bear additional costs incurred due to delay in obtaining the permission, and pay damages for delay in completion of the facility due to delay in obtaining permission. When the appointed business demands the administrator to cooperate for obtaining permission, the administrator shall be obliged to cooperate as necessary by submitting necessary documents, etc. (a private business must obtain permission under the business acts from the competent authorities at its own responsibility. However, as for permission pertaining to the provision etc., of the public facility, etc., not subject to business acts, the administrator, etc. shall cooperate as necessary due to the public nature of the project). Also, the administrator shall have the obligation to obtain permission required, and the appointed business shall have the obligation to cooperate for it. When there is delay in the administrator, etc. to obtain permission, the scheduled date of delivery (or start of operation) may be postponed, etc.
- Regarding obtaining of permission and authorization, etc. the Risk Guidelines provide that "delays in the completion or renewal of procedures specified by laws and regulations, etc. 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 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 such negotiations, 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." (Risk Guidelines II-6 (4)).

1-10 Neighborhood Briefing

1. Outline

- Provide that the appointed business shall have the obligation to brief the neighborhood residents on the construction work of the facility and survey the impact of the construction work on the life of neighborhood residents at its own responsibility and cost in accordance with applicable laws and regulations and municipal ordinances. Also provide that, if found necessary, the administrator, etc. shall have the obligation to cooperate for the briefing of neighborhood residents by the appointed business, etc.

2. Purpose

- When implementing the selected project, it is necessary to survey the impact of the construction work on the life of neighborhood residents, such as noise and traffic jams, etc. and brief them on it. The appointed business has the obligation to carry out the neighborhood briefing, etc. on its own responsibility and cost and, if found necessary, the administrator, etc. has the obligation to extend cooperation. Liability for damage when neighborhood residents suffer damage due to implementation of a PFI project is explained in "2-2-8 Damage to Third Parties (Design and Construction Phase)" and "3-5 Damage to Third Parties (Maintenance and Operation Phase)."
- It is also common to provide that the appointed business shall have the obligations to report the contents and results, etc. of the neighborhood briefing, etc. to the administrator, etc. before and after the briefing.

3. Impact of the construction work on the life of neighborhood residents

- The impact of the construction work of the facility on the life of neighborhood residents may include noise, odors, light pollution, dust, traffic jams, polluted water, vibrations, ground subsidence, and disruption of groundwater, etc.

4. Scope of neighborhood measures required

- It is common to provide that the scope of neighborhood measures the appointed business must take shall be limited to a reasonably required scope, etc.

2. Matters Relating to the Design and Construction Work of the Facility

2-1 Matters Relating to Design of the Facility

Provide that the appointed business shall have the obligation to design the facility at its own responsibility and cost in accordance to the PFI project contract, bid instructions, etc., and bid proposal.

2-1-1 Design of the Facility and Submission of Design Drawings

1. Outline

- Provide for (1) the submission of design drawings by the appointed business and their verification by the administrator, etc.; (2) measures to be taken for inconsistencies between the submitted drawings and the bid proposal, etc.; and (3) outsourcing, etc. of design to a third party.

2. Submission and verification of design drawings

- The appointed business has the obligation to design the facility in accordance with the PFI project contract, bid instructions, etc., and to bid proposal at its own responsibility and cost. Provide that the appointed business shall design the facility while receiving regular verification of the progress by the administrator, etc. or having meetings with the administrator, etc. regarding the progress. When the basic design and detailed design are included in the selected project, also provide that the appointed business shall submit the basic and detailed design drawings, etc. upon completion of each to the administrator, etc. and receive verification, etc. by the administrator, etc. The administrator, etc. verifies within a certain period to check if the drawings conform, etc. to the PFI project contract, bid instructions, etc., and the bid proposal, and notifies the same to the appointed business thereof.
- When inconsistencies are found between the submitted drawings and the PFI project contract, bid instructions, etc., and the bid proposal, the administrator, etc. promptly notifies the appointed business thereof. Provide that the administrator, etc. shall not bear any responsibility for the design and construction work of the facility on the ground that it held meetings, received the design drawings, and notified of inconsistencies between the submitted drawings and the PFI project contract, etc.

3. Obligation to submit design drawings and responsibility to correct inconsistencies between them and the PFI project contract, etc.

- Provide that the appointed business shall promptly submit the basic and detailed design drawings upon completion of each for verifying on conformity to the PFI project contract, bid instructions, etc., and bid proposal; and start the next step upon receiving the notification of verification from the administrator, etc. Also provide that the administrator, etc. shall verify the submitted design drawings within a certain period and notify the appointed business of any inconsistencies found between the submitted design drawings and the PFI project contract, bid instructions, etc., and bid proposal.
- Provide that, when inconsistencies are found in the submitted design drawings and the PFI project contract, bid instructions, etc., and bid proposal, the appointed business shall correct them at its own responsibility and cost, submit the corrected drawings to the administrator, etc., and have them verified. Since the design drawings in the selected project are gradually detailed and complemented in the process, the administrator, etc. and the appointed business may not agree on the inconsistencies found by the administrator, etc. Therefore, it is common to provide that the administrator, etc. and the appointed business shall hold regular meetings, etc. during the design period; that the appointed

business may express opinions on the inconsistencies notified of by the administrator, etc.; and that, when the administrator, etc. finds the opinions reasonable, the appointed business needs not make corrections.

- When the schedule of the phases following the design phase is delayed due to correction of inconsistencies between the PFI project contract, bid instructions, etc., and detailed design drawings, provide for sharing of responsibility and additional costs in PFI contract. When the schedule of the phases following the design, such as the delivery (or start of operation) of the facility, is delayed for reasons attributable to the appointed business, provide that the appointed business shall bear the responsibility and additional costs, and the administrator, etc. shall have the right to claim delay damages.
4. Relationship between verification of design drawings and responsibility for the design
- It is necessary to provide that the responsibility of the appointed business regarding the design of the facility and the construction work based on the design drawings shall not be reduced or exempted due to the fact that the administrator, etc. (1) verifies or holds regular meetings with the appointed business on the design; (2) notifies the appointed business about this verifications, etc. of the design drawings; (3) notifies the appointed business of inconsistencies between the proposed design drawings and the PFI project contract, etc.; and (4) examines the VE (value engineering) proposal made by the appointed business, etc.
5. Outsourcing of design to a third party, etc.
- Provide that the appointed business shall have the obligation to notify the administrator, etc. or obtain approval when entrusting or contracting out the design to a third-party design company.
 - Provide that, when the appointed business entrusts or contracts out the design to a design company that is a consortium member company (or entrusted/contracting company), all matters attributable to the design company shall be attributable directly to the appointed business notwithstanding provisions of the contract for work, etc.
 - Also provide that all matters attributable to a third party employed by the appointed business shall be attributable to the appointed business, and it shall bear responsibility.
6. Common specifications
- The design standards, which the appointed business must comply with, may be set in accordance with provisions of the PFI project contract relevant to the applicable laws and regulations, as well as by referring to the technical standards in the common specifications, etc. for the purpose of establishing the function and performance, etc. required of the facility.

In addition, for projects related to public buildings, it is possible to refer to the Uniform Standards for Building and Repair of Administrative Buildings.

7. VE proposal by the appointed business

- In a PFI project, the appointed business usually designs the facility as part of the selected project in accordance with the PFI project contract, the bid instructions, etc. including the design criteria, and the bid proposal including the planned design drawings, etc. explaining the basic concept and design of the facility.
- However, it is possible to exclude the design of the facility from the selected project and provide that the appointed business shall implement the construction work in accordance with the PFI project contract including or attached with the basic and detailed design drawings of the facility, bid instructions, etc., and bid proposal, and that the appointed business may change the design drawings presented by the administrator, etc. by making a VE proposal (post-contract VE).
- The aforementioned VE proposal by the appointed business after conclusion of the PFI project contract aims at reducing the costs of construction work, maintenance, and operation through the active use of private technologies. A VE proposal should ensure the reliability and safety of the construction work and offer equivalent or better functions and performance, etc. as well as superior efficiency compared to the subject matter set forth in the design drawings.
- If the amount of reduction in the construction costs achieved by the VE proposal of the appointed business is entirely reflected in reduction of the service consideration equivalent to the construction costs, the appointed business may lose economic motives to make a VE proposal. Therefore, a certain percentage of the service consideration equivalent to the reduced construction costs is not reduced from the service consideration. For example, it is possible to arrange that an amount equivalent to half of the amount expected to reduce due to the VE proposal (VE management cost) will not be reduced.

2-1-2 Design Changes, and Design Changes Due to Changes in Laws and Regulations

1. Outline

- Provide for (1) the scope of design changes allowed upon request of the administrator, etc. or the appointed business; (2) the procedure taken by the other party, such as consideration and approval when changes are requested; and (3) the allocation of additional costs, etc. when changes are made. Also provide for the allocation, etc. of additional costs when changes are made due to changes in laws and regulations.

2. Design changes upon request of the administrator, etc.

- Provide that the administrator, etc. may request the appointed business to make design changes if found necessary. To set the limit to design changes, it is common to provide that the changes shall not deviate from the bid proposal or change the construction period. It is also possible to provide that the administrator, etc. may request consultation with the appointed business to change design, etc. during the construction period.
- As for the specific procedure, provide that, when the administrator, etc. requests the appointed business to make design changes, the latter shall examine whether the changes are appropriate, and notify the administrator, etc. of the results within a certain period (the appointed business is also expected to examine additional costs, etc. to be incurred due to the changes and notify thereof), and the administrator, etc. shall determine the necessity of the changes based on the notification and notify the appointed business of the decision, which the latter shall follow.
- It is common to provide that the additional costs arising from design changes requested by the administrator, etc. shall be shared by both the parties according to the level of responsibility. Additional costs arising from the changes may include design costs, construction costs, future maintenance and operation costs, and financial costs (various costs required for additional funding such as interest payment, etc.). When there are inconsistencies in the design drawings created by the appointed business and the PFI project contract, etc., bid instructions, etc., and bid proposal, it is not attributable to the administrator, etc., and the appointed business must correct the inconsistencies at its own cost and responsibility.
- When design changes are made upon request of the administrator, etc., it is necessary to consider not only the additional costs but also the postponement of the scheduled date of delivery (or start of operation). The administrator, etc. may bear additional costs without changing the scheduled date of delivery (or start of operation) and on the condition that the appointed business completes the facility by that date, or the administrator, etc. may postpone the scheduled date of delivery (or start of operation) for a reasonable period and bear additional costs on the condition that the appointed business completes the facility by that date. The former option is selected if the administrator, etc. prioritizes the commissioning of the operation by a certain date. In this case, however, additional costs are expected to be relatively high. In case of the latter, since the scheduled date of delivery (or start of

operation) is postponed, the commissioning of the service consideration payment will be delayed. It is therefore necessary to consider how the delay in the start of the service consideration payment may affect the loan repayment by the appointed business.

- Regarding the above, when the scheduled date of delivery (or start of operation) is postponed, it is necessary to consider whether the end date of the maintenance and operation period is also postponed or whether the maintenance and operation period is shortened with the unchanged end date. In case of the former, the maintenance and operation period remains unchanged, but the payment of the service consideration will be delayed overall. In case of the latter, it is necessary to consider the service consideration that the appointed business will lose as a result of the shortened maintenance and operation period. (Related: 1–4 Project schedule)
 - When the costs pertaining to the provision of the facility borne by the appointed business decrease due to design changes requested by the administrator, etc., the amount of the reduction may be deducted from the service consideration within a reasonable scope.
 - When design changes requested by the administrator, etc. are not approved, a facility not desired by the administrator, etc. may be built that lacks economic rationality. Therefore, approval of the appointed business may not be necessary for design changes that do not change the construction period, as long as the administrator, etc. bears the additional costs.
3. Design changes upon request of the appointed business
- Design changes requested by the appointed business must be approved in advance by the administrator, etc. regardless of whether they deviate, etc. from the bid proposal, from the viewpoint of ensuring, etc. a fair proposal screening. It is also common to provide that the administrator, etc. and the appointed business shall share the additional costs arising from the design changes according to the level of responsibility.
4. Design changes due to changes in laws and regulations
- In some cases, laws and regulations that are directly related to the selected project are identified, and additional costs due to changes in such laws and regulations are borne by the administrator, etc., while additional costs due to changes in laws and regulations that widely affect the private businesses in general are borne by the appointed business. (Related: 5–3 Right to Cancel Due to Force Majeure, etc.)
 - When design changes are made due to changes in laws and regulations directly related to the selected project, it is necessary to consider the postponement of the scheduled date of delivery (or start of operation) as explained in the above 2. When design changes are made due to changes in non-related laws and regulations, the scheduled date of delivery (or start of operation) is not usually changed, a risk borne by the appointed business.
5. Design changes in lieu of additional costs

- It may provide that, when the administrator, etc. must bear additional costs pursuant to other provisions of the contract, and if there are special grounds, the administrator, etc. may make changes to the detailed design drawings for the purpose of reducing the costs in lieu of the additional costs, from the viewpoint of executing the budget.
6. Provisions of the Standard Contract Terms (reference)
- Under a general contract for public work, the orderer may make changes to the design drawings, if he/she finds it necessary, upon notifying the contractor of the changes. In this case, the orderer must change the construction period or the contract price if needed, and bear necessary costs for any damage caused to the contractor (Article 19 of the Standard Contract Terms). As for the design changes in lieu of changes in the contract price, when the orderer needs to increase the contract price or bear costs, and if there are special grounds, the orderer may make changes to the design drawings in lieu of all or a part of the increase in the contract price or the cost, upon consulting the contractor regarding the details of the changes (however, when a conclusion is not reached within a certain period after the consultation starts, the orderer decides on the changes and notifies the contractor) (Article 31 of the Standard Contract Terms).

2-2 Matters Relating to the Construction Work of the Facility

1. Outline

- Provide that the appointed business shall have the obligation to construct the facility in accordance with the PFI project contract, bid instructions, etc. and bid proposal.

2. Risks relating to the construction work of the facility

- Risks relating to the construction work of the facility include (1) delay in the completion of the facility, (2) increase in the construction costs, (3) failure to fulfill the required standards for the facility, and (4) damage, etc. to third parties due to the construction work. These risks materialize as lost profits of the public service due to the failure in delivering the facility and starting its operation as scheduled, additional costs due to delay in the construction work, and liability for damage to third parties, etc.
- Factors of such damage, etc. can be categorized as (1) those attributable to the appointed business, (2) those attributable to the administrator, etc., (3) those attributable to both the appointed business and the administrator, etc., and (4) those attributable to neither the appointed business nor the administrator, etc.
- Due to reasons occurring during the construction phase may lead to cancellation of the PFI project contract. This is explained in "5. Termination of contract."
- Unless the appointed business completes the construction works of the facility and starts providing public services, the administrator, etc. does not normally have the obligation to pay the service consideration, and the appointed business cannot receive it. Therefore, the appointed business has a great economic motive for completing the construction work of the facility and starting the provision of public services. For the appointed business, delay in completing the construction work of the facility and starting the provision of public services due to its own fault is a bigger risk in a PFI project than in a normal public project.

2-2-1 Construction Work of the Facility

1. Outline

- Provide that the appointed business shall have the obligation to provide the facility at its own responsibility and cost in accordance with the PFI project contract, bid instructions, etc., and bid proposals. Also provide that the appointed business shall determine the construction method and all other means necessary for completing the facility at its own responsibility.

2-2-2 Delivery of the Land

1. Outline

- Provide for the timing of delivery of the land lent to the appointed business by the administrator, etc. for the purpose of being used for the selected project (hereinafter, project land), the status of the project land at the time of delivery, and the obligation of the appointed business to retain the project land with due care of a prudent manager after the delivery.

2. Purpose

- Regardless of whether the selected project is under BOT or BTO scheme, when the appointed business implements the selected project on land owned by the administrator, etc., it needs to deliver the project land to the appointed business to start the construction work, etc. It is necessary to specifically and clearly provide for the timing of delivery of the project land and the status of the project land at the time of delivery, since they may have an impact on the start of the construction work of the facility, the following project phases such as the start of the maintenance and operation, and the details of the project such as the project costs.

3. Date of delivery

- It is important to specifically and clearly provide for the date of delivery of the project land depending on the contents of the project, etc. Examples of the date are as follows:
 - 1) A specific date
 - 2) The date of conclusion of the PFI project contract
 - 3) The date set forth in the separately concluded land lease
 - 4) The start date of land surveys such as the area survey
 - 5) The start date of the construction work
- The timing of delivery of the project land may be set forth in the schedule attached to the PFI project contract.

4. State of the land at the time of delivery

- Regarding the status of the project land at the time of delivery from the administrator, etc. to the appointed business, it is common to provide that the land shall be delivered, etc. in the present status or in a state where the construction work is possible.
- The status of the land at the time of delivery is an important precondition for the appointed business to calculate the construction costs. Therefore, the administrator, etc. should set it forth specifically in the bid instructions, etc. at the time of public tendering.
- It is also possible to provide for measures to be taken when the status of the project land at the time of delivery is different from the status set forth in the PFI project contract, as well as changes in the

construction period or the allocation of additional costs due to delay in the delivery, according to the responsibility of the administrator, etc. and the appointed business.

5. Obligation of the appointed business to retain the land with due care of a prudent manager
 - Provide that the appointed business shall have the obligation to retain the land with due care of a prudent manager after taking delivery (Article 400 of the Civil Code). Article 16, paragraph (2) of the Standard Contract Terms also provides that the contractor shall have the obligation to retain the project land with due care of a prudent manager.

2-2-3 Surveys Relating to the Construction Work

1. Outline

- When surveys required for construction work of the facility such as the land survey and geological survey, etc. are included in the selected project, provide that the appointed business shall have the obligation to carry out the surveys and bears responsibility and additional costs, etc. arising from faults and errors, etc. in the surveys. Also provide for the allocation of additional costs for repair, etc. and measures regarding delay in the project schedule when defects are found in the land through the surveys.

2. Responsibility and costs for faults, etc. in surveys

- Provide that when surveys required for construction work of the facility such as land survey and geological survey, etc. are included in the selected project, the appointed business shall be obliged to carry out the surveys at its own responsibility and cost, and bear all responsibility and additional costs, etc. arising from faults and errors in the surveys.
- The administrator, etc. provides private businesses with documents related to the land in the bid instructions, etc. for performing the selected project, and the private businesses calculate the costs of design and construction work, etc. based on these documents. Later on, the appointed business carries out surveys required for construction work of the facility as part of the selected project and designs and builds the facility based on the survey results.

Therefore, it is possible to provide that, when the appointed business finds defects in the land, not reasonably predicted or expected based on the received land-related documents provided by the administrator, etc. in the bid instructions, etc. as a result of surveys of the land, and when there are significant differences between the land-related documents provided by the administrator, etc. and the results of the surveys, etc. carried out by the appointed business, the administrator, etc. shall bear the reasonable additional costs incurred by the appointed business and take measures such as changing the project schedule as necessary.

- Defects in the land found through the buried cultural property and soil pollution surveys in particular may largely affect the project costs and schedule and even lead to cancellation of the PFI project contract depending on the details of the defects. Therefore, it is highly necessary to specifically and clearly provide for the allocation of risks between the contract parties.
- Regarding risks relating to surveys and design, the Risk Guidelines say "if a selected project includes part or all of surveying, geological survey, etc. 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 reasons." A general contract for public work also provides that, when the characteristics and geology of the construction site, etc. differ from descriptions in the design drawings, the construction period may be extended upon notification to the supervisor and surveys (Article 18 of the Standard Contract Terms).

3. Other surveys, etc. required for construction work of the facility
 - In addition to the area survey and geological survey, surveys, etc. carried out by the appointed business for the construction work may include surveys, etc. on the impact on houses in surrounding areas and TV interferences. The appointed business needs to determine the necessary surveys depending on details of the facility, type of construction work as well as local characteristics.

4. Survey, etc. procedure
 - It is common to provide that the appointed business shall have the obligation to notify the administrator, etc. prior to carrying out the surveys. Also, for the speedy implementation of the project, the appointed business may carry out the surveys, etc. upon notifying to and obtaining approval of the administrator, etc. before getting delivery of the project land.

2-2-4 Submission of the Construction Work Plan

1. Outline

- Provide that the appointed business shall have the obligation to prepare and submit to the administrator, etc. a construction work plan including the schedule of the construction work of the facility, and to keep records of the construction work, etc.

2. Purpose

- The PFI project contract is usually concluded based on the total amount of construction works of the facility in the selected project, and the appointed business has the obligation to complete the construction work during the scheduled period; unless otherwise provided, it has no obligation to complete each step of the construction work, etc. by a specific date as indicated in the construction work schedule. The construction work schedule, etc. is used as the standard by which the administrator, etc. checks the construction progress. by the appointed business. (Related: 1-4 Project Schedule)
- Although the appointed business is expected to carry out the construction work autonomously according to its capacity, involvement of the administrator, etc. may become necessary in some cases. However, when the overall impact on the selected project is considered small, excessive involvement of the administrator, etc. may be inappropriate. It is therefore desirable to focus on the appointed business to complete the construction work and prepare for providing the services by the facility completion date or the start date of maintenance and operation set forth in the project schedule.

3. Provisions of the Standard Contract Terms (reference)

- Article 3, paragraph (2) of the Standard Contract Terms provides that the construction work schedule shall not bind the contract parties unless otherwise provided in the Contract Terms.

4. Submission of the construction work plan, etc.

- It is common to provide that the appointed business shall (1) prepare a construction work plan including the overall construction schedule and complementary monthly or weekly construction schedules; (2) submit the construction work plan including the overall construction schedule to the administrator, etc. before commencing the construction work; and (3) submit the monthly or weekly construction schedules on a specific date or as requested by the administrator, etc.
- It is desirable that the contract parties consider and provide in the PFI project contract whether the administrator, etc. needs to verify the construction work plan, etc. submitted by the appointed business (consider whether it will be used as a basis for calculation when changing the service consideration, etc.).
- When the appointed business transfers its obligation to a construction company entrusted with or contracted for the actual construction work, provide that records of the construction works must be kept.

2-2-5 Implementation by Third Parties (Construction Work)

1. Outline

- Provide that the appointed business (1) may entrust or contract out the construction work of the facility to a third party, but shall bear all responsibilities for such outsourcing; and (2) shall have the obligation to submit the work ledger, etc. to the administrator, etc.

2. Scope of responsibility of the appointed business

- When consortium member companies newly establish a corporation which becomes the appointed business, the appointed business usually entrusts or contracts out the construction work to a construction company that is a consortium member company (or entrusted/contracting company). Provide that, even when entrusting or contracting out the construction work to a construction company, all matters related to the construction company or other third parties shall be attributable to the appointed business by the administrator, etc., regardless of whether provided or not for the contract.
- The Construction Business Act provides that a construction business operator shall not blanket subcontract a construction work to another operator by using whatever method, and that a person who operates a construction business shall not undertake a blanket subcontract for construction work from a construction business operator which has been contracted for it (Article 22, paragraph (1) and (2) of the Construction Business Act). As exceptions to the prohibition of blanket subcontract, these provisions do not apply when the main contractor has obtained the written consent of the orderer in advance (Article 22, paragraph (3) of the Construction Business Act). Therefore, in some cases, the PFI project contract may provide that, when the appointed business contracts out the construction work to a construction company, and if the latter requests the approval of the former for blanket subcontracting to a third party, the appointed business must not give the approval.
- For reference, since blanket subcontracting should be prohibited in public works regardless of approval of the orderer, the Proper Tendering and Contracting Act provides that Article 22, paragraph (3) of the Construction Business Act shall not apply for public works and that blanket subcontracting shall not be allowed in any case (Article 14 of the Proper Tendering and Contracting Act).

3. Submission of the work ledger, etc. to the administrator, etc.

- In a PFI project, bidders are usually required to present in the bidding proposal the name of the construction company that will carry out the actual construction work so that the administrator, etc. knows about it.
- Generally, construction work usually consists of independent specialized works. Therefore, under the Construction Business Act, when the special construction business operators subcontract the construction work directed contracted from the orderer by a subcontract of a certain price or more, they have the obligation to prepare a work ledger and work plan, etc. (Article 24-7 of the Construction Business Act and Article 7-4 of the Cabinet Order for Enforcement of the Construction Business Act).

For reference, when the Proper Tendering and Contracting Act applies, they have the obligation to submit a copy of the work ledger to the orderer (Article 15, paragraph (1) of the Proper Tendering and Contracting Act).

- As mentioned above, when the construction company in the selected project is a special construction business operator, and when it subcontracts the construction work directly from the orderer by a certain price or more, it has the obligation to prepare a work ledger, etc. pursuant to the Construction Business Act. Therefore, to ensure proper execution of the construction work, provide that the administrator, etc. may require the appointed business to submit the work ledger, etc. prepared by the construction companies and report on these construction companies, and that the appointed business shall notify the administrator, etc. of any changes to the subcontractors.

2-2-6 Appointment of a Construction Supervisor

1. Outline

- Provide that the appointed business shall have the obligation to appoint a construction supervisor at its own cost before starting the construction work of the facility in accordance with the Building Standards Act. Also provide that the appointed business shall have the obligation to notify the administrator, etc. of the name of the appointed construction supervisor and require the construction supervisor to make reports, etc.

2. Provisions of the Building Standards, etc. Act

- The Act on Architects and Building Engineers provides that the construction supervisor shall be responsible for verifying whether the construction work is carried out in accordance with the design drawings (Article 2, paragraph (8) of the Act on Architects and Building Engineers).
- The Building Standards Act provides that, in case of construction of buildings specified in Article 3 through Article 3-3 of the Act on Architects and Building Engineers, the building owner must appoint a construction supervisor who is an architect specified in Article 3 through Article 3-3 of the Act on Architects and Building Engineers (Article 5-6, paragraph (4) of the Building Standards Act and Article 3 through Article 3-3 of the Act on Architects and Building Engineers).
- Therefore, when a PFI project involves construction of buildings specified in the Building Standards Act, the appointed business, the building owner, must appoint a construction supervisor for the construction work.

3. Reporting by the construction supervisor

- The PFI project contract provides that the appointed business shall have the obligation to appoint a construction supervisor before starting the construction work and notify the administrator, etc. of his/her name promptly after the appointment. It is also to provide that the approval of the administrator, etc. may be required when appointing a construction supervisor.
- The PFI project contract usually provides that the appointed business shall have the obligation to require the construction supervisor to make regular reporting to the administrator, etc. or that the administrator, etc. may request the construction supervisor to make reports as necessary to know the situation of the construction work.

2-2-7 Changes to the Construction Period

1. Outline

- Provide that, when a contract party requests changes to the facility construction period, the contract parties shall hold consultation to determine the propriety of the changes (when consultation is not successful, the administrator, etc. sets a reasonable construction period, and the appointed business follows it) and decide on the allocation of additional costs required for making the changes.

2. Relationship between changes to the construction period and delay in the project schedule

- Even when changes are made to the construction period, the project schedule such as delivery (or start of operation) of the facility to the administrator, etc. may not be delayed. It must be noted that it is necessary to distinguish the allocation of additional costs due to the changes from provisions regarding the allocation of damages such as penalties for delay in the project schedule, while maintaining consistency between both.
- Specifically and clearly provide for the allocation of damages in case of delay in the project schedule, such as delivery (or start of operation) of the facility from the appointed business to the administrator, etc., due to changes to the construction period. (Related: 2-4-2 Delay in Delivery (or Start of Operation))

3. Allocation of additional costs due to changes to the construction period

- In principle, additional costs due to changes to the construction period are borne by the administrator, etc. within a reasonable scope when the changes are made due to defects in the project land or for reasons attributable to the administrator, etc., and by the appointed business when the changes are made for reasons attributable to the appointed business.
- As in the case of changes to the design (2-1-2), when there are changes to the construction period, it is necessary to consider not only the additional costs but also the postponement of the scheduled date of delivery (or start of operation). The administrator, etc. may bear additional costs without changing the scheduled date of delivery (or start of operation) and on the condition that the appointed business completes the facility by that date, or the administrator, etc. may postpone the scheduled date of delivery (or start of operation) for a reasonable period and bear additional costs on the condition that the appointed business completes the facility by that date. The former option is selected if the administrator, etc. prioritizes starting the operation of the facility by a certain date. In this case, however, additional costs are expected to be relatively high. In case of the latter, since the scheduled date of delivery (or start of operation) is postponed, the start of the service consideration payment will be delayed. It is therefore necessary to consider how the delay in the start of the service consideration payment may affect the loan repayment by the appointed business.
- Regarding the above, when the scheduled date of delivery (or start of operation) is postponed, it is necessary to consider whether the end date of the maintenance and operation period is also postponed,

or whether the maintenance and operation period is shortened with the unchanged end date. In case of the former, the maintenance and operation period remains unchanged, but the overall payment of the service consideration is delayed. In case of the latter, it is necessary to consider the service consideration that the appointed business will lose as a result of the shortened period of maintenance and operation. (Related: 1–4 Project schedule)

4. Provisions of applicable laws and regulations

- The Construction Business Act provides that a contract for construction work must include "provisions regarding changes to the period of construction, changes to the amount of the contract fee and payment of damages and the method of calculation for the amount in the event of an offer from one of the parties for design changes, delay to the commencement of construction or suspension of all or part of the construction work" and "provisions regarding changes to the period of construction due to natural disasters and other Acts of God and the payment of damages and the method for calculating the amount" (Article 19, paragraph (1), item (v) and item (vi) of the Construction Business Act). It is also necessary to provide for the allocate additional costs due to changes to the construction period in a PFI project contract.
- A general contract for public work provides that the method of changing the construction period shall be decided upon consultation between the orderer and the contractor in principle, and if an agreement is not reached within a certain period, the orderer shall make the decision and notify the contractor (Article 24, paragraph (1) of the Standard Contract Terms).
- Delay in completion of the construction work, which may occur due to changes to the construction period, is a major risk in the construction work (Risk Guidelines II 3), Therefore, it is necessary for the administrator, etc. and the appointed business to provide for measures to be taken when the risk materializes, including the allocation of additional costs, specifically and clearly while avoiding ambiguity as much as possible.
- Delay in completion of the construction work may be caused by reasons such as the inappropriate schedule management, etc. by the appointed business, changes to the design by the administrator, etc. for a reason, delay in the provision of a facility closely related to the public facility, etc. pertaining to the selected project of the administrator, etc. or other parties, and delay, etc. for reasons not attributable to any party and unavoidable despite reasonable measures by the contract parties such as force majeure. When completion of the construction work is delayed, the appointed business may incur additional costs such as labor costs as well as loss due to increased loan interest payment, and the administrator, etc. may incur loss such as the costs of purchasing an alternative service. Therefore, it is necessary to agree in an agreement that, when the appointed business notifies completion of the public facility, etc. and the facility is found to not meet the required public service standards set forth in the agreements and specifications, etc. as a result of trial runs of the equipment and devices, the construction work is considered incomplete, and completion of its repair is considered completion of the construction work. (Risk Guidelines II 3 (1) Reference (1))

2-2-8 Damage to Third Parties (Design and Construction Phase)

1. Outline

- Provide that the appointed business shall bear responsibility for damage, etc. caused to third parties due to the construction work of the facility; however, the administrator, etc. shall bear responsibility for damage, etc. caused for reasons attributable to the administrator, etc.

2. Allocation of neighborhood coordination costs

- Although the administrator, etc. is responsible for neighborhood coordination relating to the implementation of the project itself, it may not be always clear whether failure in the neighborhood coordination is due to the implementation of the project itself or the construction work by the appointed business. In this case, the contract parties need to hold consultation to determine the responsibility and allocation of costs.
- It is desirable that the administrator, etc. clarifies the responsibility and allocation of costs regarding matters that are expected to considerably impact the life of neighborhood residents, from the viewpoint of the location of the facility and the content of the project, etc., in the bid instructions, etc.

3. Liability for damage to third parties

- Provide that, when damage is caused to third parties due to construction work of the facility, the appointed business shall compensate the third parties; however, when the damage is caused for reasons attributable to the administrator, etc., the administrator, etc. shall compensate the third parties.

4. Damage due to normally unavoidable reasons

- It is common to provide for the allocation of damage, etc. caused to third parties for reasons that are normally unavoidable in the construction work of the facility such as noise, etc. separately from the allocation of damage caused for other reasons.
- When damage is caused to third parties for reasons that are normally unavoidable in construction works such as noise, vibrations, ground subsidence, and disruption of groundwater, the appointed business or the administrator, etc. may be held liable for damage depending on the cases. It is desirable that the contract parties consider which is appropriate for the selected project and provide it in the PFI project contract properly. However, when the above reasons are due to the breach of duty of care of a prudent manager in the construction work of the appointed business, it is held liable for damage. These problems are related to problems of surveys required for the construction work, and it is necessary to ensure consistency between these provisions in the PFI project contract. (Related: 2-2-3 Surveys Relating to the Construction Work)
- When the reasons are not expected to be avoidable even if other private businesses carry out the construction work, it may not be reasonable to make the appointed business bear all of the risks. This may be particularly true when the project land is designated in advance by the administrator, etc.

However, it is necessary to note that if the administrator, etc. is made liable for damage, the appointed business may fulfill the duty of care of a prudent manager passively and lose the economic motive to actively employ superior methods to prevent damage.

- Article 29, paragraph (2) of the Standard Contract Terms provides that, when damage is caused to third parties for reasons that are normally unavoidable in construction work such as noise, vibrations, and ground subsidence, etc. the orderer shall be held liable for the damage (however, if it is due to negligence of the duty of care of a prudent manager of the contractor, the contractor is held liable for damage). This is because the contractor may reserve and reflect its share of damage in the contract price; moreover, since a public work project is ordered based on specifications and a public body becomes the orderer under the contract for work, the public body which is the orderer is considered liable. On the other hand, a PFI project adopts the performance-based ordering, and the appointed business, which is a counter party to the contract for the administrator, etc., becomes the orderer and enters into a contract for construction work of the facility with the construction company which is the contractor; therefore, the appointed business may be considered liable, etc. However, on the ground that it is the administrator, etc. that entrusts the entire PFI project to the appointed business, or when the project adopts a method resembling the specification-based order such as the VE proposal, the administrator, etc. may be considered liable.

5. Responsibility under related laws and regulations

- The following examples show matters for which the administrator, etc. may be held responsible in a PFI project:
 - 1) Responsibility regarding public structures or structures on land (Article 2, paragraph (1) of the State Redress Act or Article 717, paragraph (1) of the Civil Code): Article 2, paragraph (1) of the State Redress Act provides that "when damage to another person is caused because of a defect in the placement or administration of a road, river, or other public structure, the State or public entity shall assume the responsibility to compensate therefor." Article 717, paragraph (1) of the Civil Code provides that "if any defect in the installation or preservation of any structure on land causes damages to others, the possessor of such structure shall be liable to the victims to compensate for those damages; provided, however, that, if the possessor has used necessary care to prevent the damages arising, the owner must compensate for the damages."
 - 2) Liability of joint tortfeasors (Article 719 of the Civil Code): When the administrator, etc. and the appointed business jointly cause damage to a third party in the construction work, the act of the administrator, etc. and the appointed business is considered a joint tort under Article 719 of the Civil Code, and the victim may claim compensation for all the damage from each party. When one of the joint tortfeasors wholly compensates the victim, that joint tortfeasor obtains the right to claim reimbursements from the other tortfeasor depending on the level of responsibility it should bear. It is also possible to agree on the allocation of damage between the contract parties in

advance. Therefore, the administrator, etc. which is the assignor of the project and the appointed business which is the assignee may agree on the allocation of damage in a PFI project contract.

6. Obligation to take out third-party liability insurance

- In many selected projects, insurance coverage can economically and reasonably reduce risks of liability, etc. for damage to third parties. Therefore, it is common to obligate the appointed business to take out related insurance, and provided for the coverage, details, and basic conditions of the insurance policy in an appendix of a PFI project contract. The insured parties may include the appointed business, the construction company contracted by the appointed business, and subcontracting companies, etc. of the construction company. (Related: 6-6 Obligation to Take Out Insurance)

2-2-9 Damage Due to Force Majeure (Design and Construction Phase)

1. Outline

- To prepare for a case where it becomes impossible to perform the design and construction work in accordance with the PFI project contract, etc. due to force majeure during the design and construction phases, provide for matters such as the handling of obligations in case of force majeure, the procedure of notification, etc. from the appointed business to the administrator, etc. in case of impossibility of performance, the allocation of damage, etc. due to force majeure, and changes to the scheduled date of delivery (or start of operation) of the facility.

2. Definition of force majeure

- Force majeure refers to external circumstances that are unrelated to the acts of parties to an agreement, etc. and are unpreventable despite taking care and prevention measures normally considered necessary. It can be categorized into natural disasters, etc. that are not attributable to the administrator, etc. or the appointed business such as storms, torrential rain, floods, high tides, landslides, cave-ins, lightning strikes, earthquakes, fires, and toxic gas, and human-made disasters such as riots, uprisings, war, and terrorist attacks. The final definition is determined by an agreement between the contract parties. (Reference: Risk Guidelines II 6 (1)) (Related: 5-3 Right to Cancel Due to Force Majeure, etc.)

3. Procedures in case of force majeure, etc.

- Provide that, when it becomes impossible to perform all or a part of the design and construction work in accordance with the PFI project contract, etc. due to force majeure, the appointed business shall immediately notify the administrator, etc. of the details and reasons of impossibility of performance in writing. After sending the notification of impossibility of performance, the appointed business is exempted from its obligation to perform work set forth in the PFI project contract, etc. within the scope affected by the force majeure while the impossibility of performance persists. However, the appointed business has the obligation to keep damage to a minimum.
- Provide that, upon receiving the notification of impossibility of performance from the appointed business, the administrator, etc. shall have the obligation to promptly carry out surveys to check the state of damage caused due to force majeure and notify the appointed business of the result. Also provide that the administrator, etc. shall hold consultation with the appointed business regarding measures such as changes to the design and construction work, etc. delay in delivery (or start of operation), and the allocation, etc. of reasonable damage and additional costs due to force majeure.
- Provide that, when an agreement is not reached in the above-mentioned consultation within a certain period, the administrator, etc. shall notify the appointed business of measures for continuing the project, and the appointed business shall have the obligation to continue the selected project accordingly. Also provide that, when the impossibility of performance by the appointed business is judged to be permanent, or when excessive costs are required to continue the selected project, the

administrator, etc. may cancel a part or the entire PFI project contract upon consultation with the appointed business regarding whether or not to continue the project. It is also possible to give the right to cancel to both the administrator, etc. and the appointed business.

4. Allocation of damage, etc. due to force majeure

- In order to give the appointed business an economic motivation to keep damage due to force majeure, etc. to a minimum, it is common to provide that, when the facility, temporary structures, construction materials already carried into the construction site, and other construction equipment, etc. have been damaged due to force majeure during the design and construction phase, the appointed business shall bear a part of the damage or additional costs incurred, and the administrator, etc. shall bear the remainder. For example, it is possible to provide that the appointed business shall bear up to a certain percentage of the total construction costs during the period or up to a certain amount, and the administrator, etc. shall bear the exceeding the estimated amount within a reasonable scope. When considering the percentage of damage borne by the appointed business, it is to be noted that the more damages the appointed business bears, the larger the costs become for bearing the risks of force majeure as it is impossible to accurately quantify its risks and the insurance restrictions, which would reflect in the costs of the contract price. Also provide that the appointed business shall bear the damage, etc. caused due to its negligence of the duty of care of a prudent manager.
- It is necessary to take into account the scope of damage. Specifically, it is desirable to clarify whether the scope of damage is limited to active damage (damage of the facility and temporary structures, etc. only) or whether it includes related damage and additional costs in general incurred by the appointed business.
- It is common to provide that the administrator, etc. shall bear the damage or additional costs incurred due to force majeure within a reasonable limit of a certain percentage of the construction costs or the portion exceeding a certain amount. In this case, the appointed business is expected to also bear expenses for the damage, etc. incurred due to force majeure within the limit of a certain percentage of the construction costs or the portion that exceeds a certain amount, and it is possible to provide for how to allocate the responsibility for damage as specifically as possible.
- A general contract for public work provides that the orderer shall bear the portion exceeding 1/100 of the contract price, thereby reducing the burden of the contractor (Article 30, paragraph (4) of the Standard Contract Terms). Here, the damage is allocated while taking into account the fact that the orderer also bears damage due to force majeure in some way instead of attributing all of it to the contractor. This is viewed as eliminating unilateralism in the work contracts and promoting healthy development of the construction industry.

5. Changes to the scheduled date of delivery (or start of operation)

- In addition to the allocation of damage incurred due to force majeure, it is necessary to consider postponing the scheduled date of delivery (or start of operation) to determine the scope of damage.

The amount of damage (including additional costs, etc.) may be allocated without changing the scheduled date of delivery (or start of operation) and on the condition that the appointed business completes the facility by that date, or the amount of damage (active damage only) is allocated upon postponing the scheduled date of delivery (or start of operation) for a reasonable period. The former option is selected if the priority is to start the operation of the facility by a certain date. In this case, the amount of damage to be borne is expected to be relatively high. In case of the latter, since the scheduled date of delivery (or start of operation) is postponed, the start of the service consideration payment will be delayed. It is therefore necessary to consider how the delay in the start of the service consideration payment may affect the loan repayment by the appointed business and the burden of the administrator, etc.

- Regarding the above, when the scheduled date of delivery (or start of operation) is postponed, it is necessary to consider whether the end date of the maintenance and operation period is also postponed, or whether the maintenance and operation period is shortened with the unchanged end date. In case of the former, the maintenance and operation period remains unchanged, but the payment of the service consideration will be delayed overall. In case of the latter, it is necessary to consider the service consideration that the appointed business will lose as a result of the shortened maintenance and operation period. (Related: 1–4 Project schedule)
6. Deduction of insurance proceeds from the allotted amount of damage, etc. due to force majeure
- It is common to provide that, when the appointed business receives insurance proceeds paid out by insurance policies related to preservation of the facility for damage due to force majeure, and if the amount of the insurance proceeds exceeds the amount of damage, etc. borne by the appointed business, the excess portion shall be deducted from the amount of damage, etc. borne by the administrator, etc.

2-3 Matters Relating to Verification by the Administrator, etc.

Provide for matters related to the administrator's, etc. verification of the status of the construction work by the appointed business to ensure proper construction work, etc. in accordance with the PFI project contract, etc. in the construction phase.

2-3-1 On-site Attendance

1. Outline

- Provide that the administrator, etc. may request explanation from the appointed business or be present at the construction site to verify the status of the construction work, etc.

2. Verification of the status of construction work by on-site attendance, etc.

- Provide that (1) the administrator, etc. may request explanation from the appointed business or construction company with (or without) prior notice or may be present at the construction site to verify the status of the construction work, etc.; (2) when the situation of the construction work is found to deviate from the design drawings, etc. from the explanation by the appointed business or direct verification by the administrator, etc., the latter shall request to make corrections, and the appointed business shall oblige to it; (3) the appointed business shall report the status of the construction work to the administrator, etc. as required; and (4) the administrator, etc. shall not bear any responsibility for the construction work just because it received explanation or report from the appointed business or verified the situation.

3. Purpose

- In order to guarantee proper provision of public service, the administrator, etc. may request the appointed business to submit regular reports on the status of the project which the latter has the obligation to comply with under the PFI project contract, while paying attention to keep its involvement in the appointed business to a necessary minimum (Basic Policy IV 4 (3) (b)). Therefore, provide that the administrator, etc. may request explanation from the appointed business and may be present at the construction site to verify the status of the construction work. It may also be provided that the construction company which is practically in charge of the construction work shall provide explanation or reports to the administrator, etc.

4. Provisions of applicable laws and regulations

- For the purpose of proper performance of the contract, the Public Accounting Act provides that “when a Contract Officer, etc. concludes a contract for work involving construction, manufacturing or other type of work, the Contract Officer, etc. shall, either personally or by assigning an assistant, undertake necessary supervision in order to ensure appropriate performance of the contract, pursuant to the provisions of Cabinet Order.” (Article 29-11, paragraph (1) of the Public Accounting Act).¹ Moreover, since cooperation of the other party to the contract is necessary in order to ensure smooth supervision, a contract must clearly provide for matters regarding supervision depending on the nature and purpose

¹ When a local government is the administrator, etc., similar provisions of Article 234-2 of the Local Autonomy Act apply.

of the contract (Article 100, paragraph (1), item (iii) of the Cabinet Order on Budgets, and Article 13 of the Contract Management Regulations).

- Regarding the method of supervision, accounting laws provide that the supervisor must prepare documents required for performance of the contract, such as detailed full-scale design drawings, etc. based on the specifications and design documents as necessary, or examine and approve such documents prepared by the other party to the contract. They also provide that the supervisor may be present on-site for performance of the contract for work to supervise the construction progress management, tests or inspections of materials used in construction and manufacturing during the performance, etc. and give instructions to the other party to the contract as necessary (Article 101-3 of the Cabinet Order on Budgets and Article 18, paragraph (1) and paragraph (2) of the Contract Management Regulations).¹ A general contract for public work provides that the supervisor may manage the construction procedure based on design drawings, be present on-site, inspect the status of the construction work, or test or inspect the construction materials (Article 9, paragraph (2) of the Standard Contract Terms).
- The PFI project contract aims at promoting the provision etc., of the public facility, etc. through the performance of the contract. Therefore, in accordance with the purpose of the above accounting laws, provide that the administrator, etc. shall request explanation from the appointed business or construction company to verify that the construction work is carried out in accordance with the detailed design, or may be present at the construction site to verify the status of the construction work, as a necessary measure to ensure performance of obligations under the PFI project contract.

¹ When a local government is the administrator, etc., Article 167-15 of the Enforcement Order of the Local Autonomy Act provides the method of supervision or inspection.

2-3-2 Construction Completion Inspection

1. Outline

- Provide for the method and effect of the construction completion inspection carried out by the appointed business and the administrator, etc. both.

2. Purpose

- Provide for the construction completion inspection carried out by the appointed business and the administrator, etc. in order to ensure proper provision of public service (Basic Policy IV 4 (3)) while paying attention to involve the administrator, etc. to a necessary minimum.

3. Method of the construction completion inspection

(Construction completion inspection by the appointed business)

- Regarding the construction work of the facility, the appointed business enters into a contract for work as the orderer with a construction company, inspects the completion of the construction, based on the contract for work, and have the facility delivered by the construction company. Since the facility is delivered to the administrator, etc. in accordance with the PFI project contract after the construction completion inspection, the completion inspection by the appointed business is considered necessary for proper performance of the PFI project contract. Therefore, provide that the appointed business shall carry out the construction completion inspection at its own cost and responsibility and report the inspection result to the administrator, etc.
- The Construction Business Act provides that the parties to a contract for construction work shall include the date and method of the construction completion inspection in the contract as an important element of the contract (Article 19, paragraph (1), item (x) of the Construction Business Act). Therefore, the construction completion inspection is provided for in the contract for the construction work of the facility concluded between the appointed business and the construction company. When the appointed business is the building owner under the Building Standards Act, and if the facility is a building specified in Article 6, paragraph (1), item (i) through item (iii) of the Building Standards Act, the appointed business must pursue the facility completion inspection pursuant to Article 7 of the Building Standards Act before the construction completion inspection.

In a PFI project contract, provide that the appointed business shall carry out the construction completion inspection at its own responsibility and cost in accordance with the contract for construction work of the facility concluded between the appointed business and the construction company, and notify this to the administrator, etc.

(Construction completion inspection by the administrator, etc.)

- Provide that, within a certain period following receiving the report of the above inspection from the appointed business, the administrator, etc. shall promptly carry out an inspection to verify that the facility meets the required standards in accordance with the PFI project contract, bid instructions, etc.,

and bid proposal, and promptly issue the construction completion certificate to the appointed business upon verifying that the facility is in conformity with the PFI project contract, bid instructions, etc., and bid proposal as the result of the inspection. Also provide that, when the facility is not found to be in conformity with the PFI project contract, bid instructions, etc., and bid proposal, the administrator, etc. may clarify the matters found and request the appointed business to correct them within a specific period, which the appointed business shall follow.

- Under accounting laws, when a subject matter of the contract is delivered by the other party to the contract which is an obligor, in order to verify the conformity of the delivery to the contract, “the Contract Officer, etc. (omitted) shall, either personally or by assigning an assistant, undertake necessary inspections in order to verify that the delivery to be received under the contract is completed” (Article 29-11, paragraph (2) of the Public Accounting Act).¹ Since cooperation of the other party to the contract is necessary for smooth inspection, a contract must include particulars of the inspection depending on the nature and purpose on the contract (Article 100, paragraph (1), item (iii) of the Cabinet Order on Budgets and Article 13 of the Contract Management Regulations). The Act on Prevention of Delay in Payment also provides that a governmental contract must include the “timing of verification or inspection of completion of the delivery which is the purpose of the contract” (Article 4 of the Act on Prevention of Delay in Payment). Similarly, in a PFI project, the administrator, etc. needs to carry out the construction completion inspection as an inspection required for verifying the delivery in accordance with the PFI project contract, and the PFI project contract provides so.
- Accounting laws provide that the method of inspection must be based on the contract, specifications, design drawings, or other related documents (Article 101-4 of the Cabinet Order on Budgets).² Article 20 of the Contract Management Regulations provides that the inspection officer must inspect the delivery based on the contract, specifications, design drawings, and other related documents, in order to verify the completion of the delivery (Article 20, paragraph (1)). Regarding the timing and effect of the inspection, the Act on Prevention of Delay in Payment provides that the inspection of the construction must be carried out within 14 days from the date the national government receives the notice of completion of the delivery from the other party to the contract (Article 5, paragraph (1) of the Act on Prevention of Delay in Payment), and when the national government finds as a result of inspection that all or a part of the delivery is in breach of or not conform to the contract, the national government may request correction or improvement (Article 5, paragraph (2) of the Act on Prevention of Delay in Payment). Under a general contract for public work, the contractor must notify the orderer of the completion of the construction, and the orderer must inspect the completion within 14 days from the date of receiving the notice, notify the contractor of the inspection results, and have the subject matter of the construction delivered if it passes the inspection. When it does not, the contractor must

¹ When a local government is the administrator, etc., similar provisions of Article 234-2 of the Local Autonomy Act apply.

² When a local government is the administrator, etc., similar provisions of Article 167-15, paragraph (2) of the Local Autonomy Act apply.

repair the portion that failed inspection and receive another inspection, and it must bear the costs required for the inspection or repair (Article 32 of the Standard Contract Terms).

Under the PFI project contract, the administrator, etc. must carry out the construction completion inspection based on the PFI project contract, as well as the bid instructions, etc. and bid proposal related to the PFI project contract, within a certain period from the date of receiving the facility completion notice from the appointed business, and notify the appointed business of the inspection results. When the facility is not found to be in conformity with the PFI project contract, bid instructions, etc., and bid proposal as the result of the inspection, the administrator, etc. may clarify specific matters found and request the appointed business to correct them.

4. Attendance of the administrator, etc. at the construction completion inspection by the appointed business
 - Provide that the appointed business shall notify the administrator, etc. its own intention to carry out a prior construction completion inspection.
 - It is common to provide that the administrator, etc. may seek its attendance at the construction completion inspection carried by the appointed business; however, the administrator, etc. shall not bear any responsibility on the ground of its attendance.

5. Attendance of the appointed business, etc. at the construction completion inspection by the administrator, etc.
 - Provide that the appointed business shall attend the construction completion inspection by the administrator, etc. for its smooth implementation. It may also be possible to provide that the construction supervisor shall attend the construction completion inspection carried out by the administrator., etc.

6. Responsibility of issuing construction completion certificate
 - Provide that the administrator, etc. shall not bear any responsibility for all or a part of construction, maintenance, and operation of the facility just because it issued the construction completion certificate.

7. Issuance of the construction completion certificate
 - Since the issuance of the construction completion certificate by the administrator, etc. to the appointed business is an important requirement for the delivery (or start of operation) of the facility from the appointed business to the administrator, etc., it is necessary to specifically and clearly provide for the conditions of issuance of the construction completion certificate (including the format of documents to submit).

2-3-3 Establishment of the Maintenance and Operation System

1. Outline

- Provide that, when the maintenance and operation of the facility in accordance with the PFI project contract, etc. becomes possible, the appointed business shall notify the administrator, etc. thereof.

2. Establishment of the operation system

- In a selected project that puts emphasis on the operation, it is necessary to ensure not only the availability of the facility but also the operation system that meets the required standards before starting the provision of public service. Therefore, when scheduling the process leading to the start of operation, the administrator, etc. needs to schedule a period required for the appointed business to establish the operation system.

3. Procedure of verification by the administrator, etc.

- Provide that, when the maintenance and operation of the facility in accordance with the PFI project contract, etc. becomes possible, the appointed business shall notify the administrator, etc. thereof. In particular, when the selected project puts an emphasis on operation, it is possible to provide for the procedure of verification by the administrator, etc. It is desirable to specifically and clearly provide for the procedure and conditions of verification by the administrator, etc.

2-4 Matters Relating to the Delivery of the Facility

Provide for matters related to the delivery of the facility built by the appointed business to the administrator, etc. Also provide that the facility shall be delivered after notification of the verification of the construction completion in the case of a selected project under BTO scheme, and the facility shall be delivered at the end of the contract period in case of a selected project under BOT scheme.

2-4-1 Delivery of the Facility (BTO Scheme)

1. Outline

- In the case of a selected project under BTO scheme, provide for the procedure to follow when the facility is delivered from the appointed business to the administrator, etc. after conducting verifications of the facility's state such as construction completion. (Related: 2-3-2 Construction Completion Inspection, 3-7 Inspection Before the End of the Contract Period)

2. Purpose

- The delivery of the facility means that the administrator, etc. has verified, etc. that the facility is complete in accordance with the PFI project contract, etc. and that the appointed business has verified that it has completed its obligation to perform the construction work of the facility, except when it is responsible for non-conformity of the construction work to the contract, etc.

3. Procedures for delivery of the facility

- It is common to provide that (1) the administrator, etc. shall issue the construction completion certificate to the appointed business, and the latter shall notify the administrator, etc. when it becomes possible to start the maintenance and operation; (2) the appointed business shall then deliver the as-built drawings and the facility to the administrator, etc. and start the maintenance and operation immediately after. It is also possible to provide a certain period between the verification of completion of the construction and the scheduled date of delivery (or start of operation) to allow the appointed business to secure and train the necessary personnel for operation.
- Specifically and clearly provide in the project schedule the timing of verification of completion of the construction for delivery or the transfer of the facility's ownership.
- Provide that, when the registration procedure is necessary for completion of the construction and delivery of the facility, the appointed business shall follow the procedure and bear the necessary costs (similarly, in case of a selected project under BOT scheme, when the registration procedure is necessary for transferring the ownership of the facility to the administrator, etc. before the end of the contract period, the appointed business shall bear the necessary costs).

2-4-2 Delay in Delivery (or Start of Operation)

1. Outline

Provide for changes to the scheduled date of delivery (or start of operation) and the allocation of damage between the administrator, etc. and the appointed business depending on the responsibility when the delivery (or start of operation) of the facility is delayed for reasons attributable to the administrator, etc. or for reasons attributable to the appointed business.

2. Purpose

- When the delivery (or start of operation) of the facility from the appointed business to the administrator, etc. is delayed, certain damage is expected to occur. Therefore, it is necessary to provide for measures to be taken when a risk materializes, such as the allocation of damage, as specifically and clearly as possible in the PFI project contract. Damage, etc. caused due to delay in delivery (or start of operation) of the facility from the scheduled date set forth in the PFI project contract is allocated depending on the reasons attributable. Delay in delivery (or start of operation) of the facility is closely related to changes in the construction period. (Related: 2-2-7 Changes to the Construction Period)
- It must be noted that it is necessary to distinguish between direct damage due to delay in the delivery (or start of operation) and additional costs (the design costs, construction costs, future maintenance and operation costs, and financial costs (costs required for additional funding such as interest payment, etc.)) incurred due to individual causes of delay (changes to the design, construction period, etc.) under provisions of the PFI project contract. Damage, etc. due to the delay in the delivery (or start of operation) means damage caused by the delay itself or, to be more specific, damage due to the fact that the public service was not provided during the delay, such as the costs of an alternative facility used by the administrator, etc. during the delay. On the other hand, additional costs incurred due to individual causes of delay are costs relating to the causes of delay and are not directly related to delay in the delivery (or start of operation). In fact, additional costs may always occur due to changes to the design or construction period, regardless of whether the delivery (or start of operation) is actually delayed. Therefore, such additional costs are subject to provisions regarding possible causes of delay, and provisions regarding delay in the delivery (or start of operation) deal with direct damage due to delay.

3. Provisions of applicable laws and regulations

- Accounting and other laws, etc. provide that the contract officer, etc. shall include in a contract the particulars of penalties in cases of delay in performance, in order to ensure propriety of the contract (Article 100, paragraph (1), item (iv) of the Cabinet Order on Budgets and Article 4, item (iii) of the Act on Prevention of Delay in Payment). Therefore, the administrator, etc. is required to provide for penalties, etc. in cases of delay in the delivery (or start of operation) of the facility in a PFI project contract.

4. Obligation to make efforts to prevent delay

- Provide that, when recognizing the risk of delay in the delivery or start of maintenance and operation of the facility, the appointed business shall have the obligation to notify the administrator, etc. of the cause of delay and the planned measures by a certain time prior to the scheduled date of delivery (or start of operation) and take measures to avoid or reduce the delay.
5. Delay in the delivery (or start of operation) for reasons attributable to the appointed business
 - When the delivery or start of operation of the facility is delayed for reasons attributable to the appointed business, it bears the amount equivalent to the damage incurred by the administrator, etc. due to the delay. Although it is difficult to prove the occurrence and amount of damage incurred by the administrator, etc. for not being able to start providing public service as scheduled, it is common to provide that the appointed business shall compensate the administrator, etc. for the damage by paying a certain percentage of the construction costs (or the construction costs for the incomplete portion) depending on the number of delayed days from the scheduled date (or start of operation) as penalties, in order to give the appointed business an economic motive to respect the date of delivery (or start of operation). It may also be provided that, when the administrator, etc. incurs damage exceeding the penalties, the appointed business shall also pay the exceeding amount.
 6. Delay in the delivery (or start of operation) for reasons attributable to the administrator, etc.
 - As explained regarding changes to the design (2-1-2), changes to the construction period (2-2-7), and the force majeure (2-2-9), when a circumstance that may cause delay in the delivery (or start of operation) arises for reasons attributable to the administrator, etc., the administrator, etc. bears the costs required for completing the facility by the scheduled date of delivery (or start of operation) (including when the date is postponed); therefore, as long as the administrator, etc. bears the additional costs, the reasons for delay in the delivery (or start of operation) can only be attributable to the appointed business. However, provide that, when delay in the delivery (or start of operation) is unavoidable even when the administrator, etc. bears additional costs, the delay in the delivery (or start of operation) shall be considered to be caused for reasons attributable to the administrator, etc., who shall compensate the appointed business for the additional costs and damage it incurred within a reasonable scope.
 - Reasonable additional costs and damage incurred by the appointed business due to delay in the delivery (or start of operation) for reasons attributable to the administrator, etc. may include the service consideration lost in case the period of operation is not extended despite delay in the delivery (or start of operation), or financial costs, etc. in case the loan repayment by the appointed business is obstructed as a result of delay in the start of the service consideration payment following the delay. In some cases, instead of compensating for individual cases of damage, payment of penalties depending on the number of days from the scheduled date to the actual date of delivery (or start of operation) may be provided as compensation.

2-4-3 Non-conformity of the Facility to the Contract

1. Outline

- Provide that, if a work item does not conform to the contract in terms of its type or quality, the administrator, etc. may claim subsequent completion of performance, reduction of remuneration, or damages, or cancel the contract.

2. Provisions of accounting laws

- The Cabinet Order on Budgets provides that a contract must include the particulars of subsequent completion of performance, reduction of the price, and cancellation of the contract depending on the nature and purpose of the contract (Article 100, paragraph (1), item (iv) of the Cabinet Order on Budgets). In a PFI project contract, provide for the warranty for non-conformity of the facility pertaining to the selected project to the contract as necessary.

3. Provisions of applicable laws and regulations

- Under the Civil Code, the duration of the contractor's warranty is one year from the date the orderer becomes aware of the non-conformity (Article 637, paragraph (1) of the Civil Code). However, this does not apply when the contractor becomes aware of the non-conformity, or is unaware of the non-conformity by gross negligence, at the time of delivery of the subject matter (Article 637, paragraph (2) of the Civil Code). In a contract for new housing construction, the duration of the contractor's warranty for any defect (non-conformity to the contract) in the basic structure, such as the parts essential to structural durability of the housing, is ten years (Article 2, paragraph (5) and Article 94, paragraph (1) and (3) of the Housing Quality Assurance Act).
- When a part or all of construction work is included in the selected project, non-conformity of the subject matter of the construction work is considered a risk relating to the construction work. Therefore, "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 subsequent completion of performance, reduction of remuneration, or damages, and cancellation of the contract 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." (Risk Guidelines II 3 (1) (Reference) (3)).
- In a general contract for public work, in principle, the duration of the warranty for non-conformity to the contract is two years from the delivery in case of the subject matter of a construction work, and one year in case of equipment, etc. However, when the non-conformity to the contract is intentional or there is a gross negligence on the part of the contractor, the Civil Code applies (Articles 45 and 57 of the Standard Contract Terms).

4. Details of the warranty for non-conformity to the contract

- Provide that, when the appointed business delivers a subject matter of the work, part of which does not conform to the contract in terms of its type or quality, the administrator, etc. may claim subsequent completion of performance, reduction of remuneration, or damages, or cancel the contract. Depending on the capacity of the appointed business, it is also possible to provide that, when the non-conformity is not essential, and if subsequent completion of performance requires excessive costs, the administrator, etc. shall not claim subsequent completion of performance by the appointed business.
5. Period for exercise of rights related to warranty for non-conformity to the contract
- In case of a selected project under BTO scheme, it is possible to provide for the warranty for non-conformity to the contract in the project contract to prepare for a case where the facility is not built in accordance with the PFI project contract, etc. The duration of the warranty may be ten years, five years, two years, etc. from the date of delivery of the facility or the issuance of the construction completion certificate.
 - In case of a selected project under BOT scheme, it is often difficult to properly apply provisions regarding the warranty of the appointed business for non-conformity to the contract after the selected project has been completed and the ownership of the facility is transferred, since it is difficult to clearly distinguish between non-conformity of the facility to the contract and incomplete maintenance performance or deterioration over time. Based on this, the duration of the warranty may be 90 days, 180 days, one year, etc. from the date of delivery of the facility or the issuance of the construction completion certificate.
 - In case of a selected project under BOT scheme, in link with the duration of the warranty for non-conformity to the contract, it may also be provided that the appointed business must not disband until a certain period passes after the ownership of the facility is transferred.
6. Guarantee of performance of obligations related to non-conformity liability
- It is conceivable to provide that the appointed business shall submit a guarantee to the administrator, etc. stating that it will act as a construction company and will fulfill its obligations related to non-conformity with this contract.

3. Matters Relating to Maintenance and Operation of the Facility

3-1 Implementation of Maintenance and Operation

1. Outline

- Provide that the appointed business shall have the obligation to maintain and operate the facility at its own responsibility and cost in accordance with the PFI project contract, bid instructions, etc., and bid proposal.

2. Time for providing maintenance and operation details, etc.

- It is necessary to provide for the details, standards, and verification method, etc. of maintenance and operation before starting maintenance and operation.

3-2 Implementation by Third Parties (Maintenance and Operation)

1. Outline

- As explained for the design of the facility (related: 2-1-1 Design of the Facility and Submission of Design Drawings) and construction work of the facility (related: 2-2-5 Implementation by Third Parties (Construction Work)), provide for outsourcing, etc. of maintenance and operation of the facility from the appointed business to third parties.

2. Outsourcing, etc. of maintenance and operation to third parties

- Provide that when the appointed business entrusts or contracts out maintenance and operation of the facility to the consortium member companies or to the maintenance and operation companies, all the matters of maintenance and operation companies shall be attributable to the appointed business under the relationship with the administrator, etc. notwithstanding provisions of the contract for maintenance and operation.
- Also provide that all matters attributable to third parties employed by the appointed business shall be attributable to the appointed business, and it shall bear responsibility.

3. Presentation and change of maintenance and operation companies

- The administrator, etc. usually requests the bidders to clearly indicate the main maintenance and operation companies that will be entrusted with or contracted for the maintenance and operation, and examines their qualifications. Work-based specifications, explained later, are prepared based on the standards and characteristics such as the financial and technical capacities, etc. of the companies that pass the examination, and the companies are expected to follow them to meet the required standards. Therefore, when the appointed business entrusts or contracts out maintenance and operation to third parties other than those indicated in the bid proposal, approval of the administrator, etc. is necessary, and it will be given unless there are reasonable grounds not to do so.
- It may also be provided that, in order to make the name, etc. of companies in charge of maintenance and operation, the administrator, etc. shall request the appointed business to submit a copy of the outsourcing contract or contract for work concluded between the appointed business and the newly employed maintenance and operation company, or between the newly employed maintenance and operation company and its subcontracting company.
- In particular, when the selected project includes operation in which an importance is placed on the company's financial and technical capacities, etc. it may be appropriate that the operation company indicated in the bid proposal by the consortium should carry out the operation for a certain period until management by the appointed business becomes stable after the project starts. Therefore, it is possible to provide that the appointed business must not change the main operation company without the approval of the administrator, etc. for a certain period after the start of operation (the administrator, etc. may give approval only when there are reasonable grounds to do so).

- When the appointed business changes the maintenance and operation company, it is necessary to make sure the appointed business does not interrupt or stagnate the work concerned, and it is possible to provide so in the contract.

3-3 Work-based Specifications

1. Outline

- When it is necessary to provide for work-based specifications that set forth the details of work to meet the required business level, provide that the administrator, etc. shall verify whether the work-based specifications meet the required level documents, etc.; if not met, the administrator, etc. may request the appointed business to correct them.

2. Preparation and submission of work-based specifications

- When details of maintenance and operation are not determined by the time of conclusion of the PFI project contract, or when the selected project puts an emphasis on operation, provide that the appointed business must prepare work-based specifications. The work-based specifications serve as the standards for monitoring carried out by the administrator, etc. to make sure the work meets the required business level.
- Provide that (1) in accordance with the PFI project contract, bid instructions, etc., and bid proposal, and upon consultation with the administrator, etc., the appointed business shall prepare work-based specifications for works relating to maintenance and operation of the facility, with a format and content necessary and appropriate for making sure that the work meets the required business level, and submits it to the administrator, etc.; (2) when all or a part of the submitted work-based specifications is reasonably found to not meet the required standards, the administrator, etc. shall specify the matters concerned in the work-based specifications and notifies the appointed business thereof; (3) in this case, upon consultation with the administrator, etc., the appointed business shall correct the matters concerned to meet the required business level at its own responsibility and cost and submit them to the administrator, etc.

3. Changes to work-based specifications

- In case of a long-term PFI project contract, it may be necessary to review the work-based specifications for reasons such as changes in the maintenance and operation companies and entrusted/contracting companies. To prepare for such case, provide that, when one of the contract parties reasonably finds it to be necessary and appropriate for performing work that meets the required business level the work-based specifications may be changed as necessary upon consultation.

3-4 Work Reports

1. Outline (Reference: Guideline for Monitoring)

- Provide that the appointed business shall have the obligation, etc. to prepare work reports and submit them regularly to the administrator, etc. as a means for the administrator, etc. to verify the status of maintenance and operation.

2. Submission procedure

- Provide (1) that the appointed business shall prepare a work diary describing the status of maintenance and operation of the facility, stores it for a certain period, and makes it available for viewing when requested by the administrator, etc.; (2) that the appointed business shall regularly submit work reports describing the status of maintenance and operation based on the work diary to the administrator, etc. for verification, until the end of the PFI project contract; (3) that the administrator, etc. shall verify the work reports submitted by the appointed business and notifies the appointed business of the result within a certain time; and (4) how the work reports are used for judging measures to be taken when the appointed business fails to meet the required work standards, such as reduction, etc. of the service consideration. Also provide for the details to include in work reports.

3. Purpose

- The Basic Policy provides that “the administrator, etc. of the public facility, etc. may request the appointed business to regularly submit reports on the situation of the project pertaining to performance of obligations in the project contract, in order to ensure proper provision of public service, while paying attention to keep its involvement in private businesses to a minimum” (Basic Policy IV 4 (3) (b)). Therefore, provide that the appointed business shall prepare and submit reports on the situation of work, as a basic means for the administrator, etc. to promptly understand the situation of the selected project and monitor the situation of performance of work by the appointed business in the maintenance and operation phase.
- The administrator, etc. verifies the situation of performance of the project by the appointed business based on the work reports submitted by the appointed business and reflects it in the payment of the service consideration to the appointed business. (Related: 4-2 Reduction of the Service Consideration)

4. Frequency of preparation of work reports by the appointed business and verification of performance by the administrator, etc.

- The administrator, etc. usually requires the appointed business to prepare and submit work reports every month and every quarter or semester to verify the situation of performance of work. The administrator, etc. may also obligates the appointed business to prepare daily reports or a work diary, etc. that records the daily status of maintenance and operation, and store them in a way that allows the administrator, etc. to view them at any time.

5. Other methods of verifying the situation of performance of work

- Methods of verifying the situation of performance of maintenance and operation include not only submission of work reports by the appointed business as described above, but also other methods such as on-site inspection by the administrator, etc. and surveys targeting the facility users. Therefore, it is desirable that the administrator, etc. add such methods based on the characteristics of the facility concerned. It is necessary to note that spending money (and time) for monitoring more than necessary is a problem in terms of the project's overall efficiency.

3–5 Damage to Third Parties (Maintenance and Operation Phase)

1. Outline

- Provide for the allocation of damage, etc. caused to third parties due to maintenance and operation of the facility by the appointed business, and that the administrator, etc. bears responsibility for damage caused for reasons attributable to the administrator, etc.

2. Allocation of neighborhood coordination costs

- Although the administrator, etc. is responsible for neighborhood coordination relating to the implementation of the project itself, it may not be always clear whether failure in the neighborhood coordination is due to the implementation of the project itself or the maintenance and operation of the facility by the appointed business. In this case, the contract parties need to hold consultation to determine the responsibility and allocation of costs.
- It is desirable that the administrator, etc. clarify the responsibility and allocation of costs regarding matters that are expected to considerably impact the life of neighborhood residents, from the viewpoint of the location of the facility, etc. and the content of the project, in the bid instructions, etc.

3. Liability for damage to third parties

- Provide that, when damage is caused to third parties due to maintenance and operation of the facility, the appointed business shall compensate the third parties for the damage. It is possible to also provide that, when the damage is caused for reasons attributable to the administrator, etc., the administrator, etc. shall compensate the third parties for the damage.
- Also provide for the liability for damage to third parties for reasons that are normally unavoidable in operation of the facility such as noise, etc.

4. Obligation to take out third-party liability insurance

- It is common to provide that the appointed business shall have the obligation to take out third-party liability insurance to compensate for damage caused to third parties (in case the work is outsourced to a third party, the third party may become the policyholder). An agreement between the appointed business and the administrator, etc. may be necessary regarding the details and basic conditions of the insurance policy, etc. It is also necessary to provide whether the insured parties shall include the appointed business, entrusted/contracting companies, maintenance and operation companies, and their subcontracting companies, etc.

5. Responsibility under related laws and regulations

- As explained in “2–2–8 Damage to Third Parties (Design and Construction Phase).”

3-6 Damage Due to Force Majeure (Maintenance and Operation Phase)

1. Outline

- To prepare for a case where it becomes impossible to maintain and operate the facility in accordance with the PFI project contract, etc. due to force majeure during the maintenance and operation phase, provide for matters such as the handling of obligations in case of force majeure, the procedure of notification, etc. from the appointed business to the administrator, etc. in case of impossibility of performance, and the allocation of damage, etc. due to force majeure.

2. Purpose

- Damage due to force majeure, such as the loss, etc. of the facility by a natural disaster, etc. during the maintenance and operation period, is likely to cause disputes regarding the allocation of damage between the administrator, etc. and the appointed business. Therefore, provide for the allocation of damage in advance. (Related: 2-2-9 Damage Due to Force Majeure (Design and Construction Phase))
- “Force majeure such as natural disasters, etc. not attributable to the administrator, etc. or the appointed business (omitted) may affect the implementation of the selected project during the maintenance and operation phase (omitted) by damaging the facility in the maintenance and operation phase (omitted) and requiring costs that exceed the agreed amount. Therefore, it is necessary to consider the allocation of additional expenditure in case of force majeure” (Risk Guidelines II 6 (1)) and provide for it specifically and clearly, avoiding ambiguity as much as possible. (Related: 2-2-9 Damage Due to Force Majeure (Design and Construction Phase))

3. Procedures in case of force majeure, etc.

- Provide that, when it becomes impossible to perform all or a part of the maintenance and operation work in accordance with the PFI project contract, etc. due to force majeure, the appointed business shall immediately notify the administrator, etc. of the details and reasons of impossibility of performance in writing. After sending the notification of impossibility of performance, the appointed business is exempted from its obligation to perform work set forth in the PFI project contract within the scope affected by the force majeure while the impossibility of performance persists. However, the appointed business has the obligation to keep damage to a minimum.
- It is possible to provide that, while the impossibility of performance persists, the administrator, etc. shall pay the appointed business for other work performed, deducting costs that the appointed business has avoided due to the impossibility of performance.
- Provide that, upon receiving the notification of impossibility of performance from the appointed business, the administrator, etc. shall have the obligation to promptly carry out surveys to check the state of damage caused due to force majeure and notify the appointed business of the result. Also provide that the administrator, etc. shall hold consultation with the appointed business regarding

measures such as changes in the details of work, and allocation of reasonable damage and additional costs due to force majeure.

- When an agreement is not reached in the above-mentioned consultation within a certain period, the administrator, etc. notifies the appointed business of measures for continuing the project, and the appointed business has the obligation to continue the selected project accordingly. When the impossibility of performance by the appointed business is judged to be permanent, or when excessive costs are required to continue the selected project, the administrator, etc. may cancel a part or all of the PFI project contract upon consultation with the appointed business. It is also possible to give the right to cancel to both the administrator, etc. and the appointed business.
4. Allocation of damage, etc. due to force majeure
- When damage is caused due to force majeure during the maintenance and operation period, it is necessary to give the appointed business an economic motive to keep the damage to a minimum. Therefore, it is common to provide that the appointed business shall bear responsibility for a part of damage or additional costs incurred due to force majeure, and the administrator, etc. shall bear the exceeding portion within a reasonable scope. The amount of damage, etc. borne by the appointed business may be:
 - 1) The total amount of damage, etc. during the maintenance and operation period, up to a certain percentage of the total maintenance and operation costs during the maintenance and operation period;
 - 2) The total amount of damage, etc. due to force majeure during one project year, up to a certain percentage of the maintenance and operation costs for one project year;
 - 3) A fixed amount.
 - Also provide that the appointed business shall bear responsibility for damage incurred due to negligence of its duty of due care of a prudent manager.

3-7 Inspection Before the End of the Contract Period

1. Outline

- Provide that the administrator, etc. shall inspect the condition of the facility before the end of the contract period, in order to prepare for the change of the project implementing body after the end of the contract period, etc.
- Provide that the appointed business shall have the obligation to inspect the condition of the facility by a certain period prior to the end of the contract period and report the result to the administrator, etc. (Related: 2-3-2 Construction Completion Inspection, 2-4-1 Delivery of the Facility (BTO Scheme))

2. Purpose

- In a selected project under BOT scheme, since the ownership of the facility is transferred to the administrator, etc. when the contract period ends, it is necessary to verify in advance that the facility is in a condition set forth in the PFI project contract. Therefore, the inspection is more detailed under BOT scheme than under BTO scheme.
- It is necessary to provide that the administrator, etc. shall have the right to enter the facility for the inspection and that the appointed business has the obligation to cooperate for the inspection by the administrator, etc.

3. Details of inspection, etc. by type of ownership of the facility

(In case of a selected project under BOT scheme)

- When the administrator, etc. plans to continue using the facility for work after the contract period ends, provide that the appointed business shall deliver the facility to the administrator, etc. in a condition that does not hinder its continuous use for work, and that the administrator, etc. shall carry out inspection before the end of the contract period to verify that facility is in such condition. It is desirable to specifically provide for items to be inspected before the delivery, as well as the required condition for each item, from the viewpoint of clarifying the allocation of risks between the contract parties in advance. Also provide that, when the condition of the facility does not meet the standards required by the administrator, etc., and if the appointed business is responsible for its non-conformity to the contract or is found to not have performed proper maintenance and operation in accordance with the PFI project contract, the administrator, etc. shall notify the appointed business thereof, and the appointed business shall have the obligation to promptly correct the matters concerned following the notification. (Related: 2-4-3 Non-conformity of the Facility to the Contract)
- For the purpose of verification, it is possible to provide that the limited property right shall not be established for the facility at the time of the delivery.
- When the ownership of the facility is transferred to the administrator, etc. for a price at the end of the PFI project contract, provide for its amount and payment method.

(In case of a selected project under BTO scheme)

- Provide that the administrator, etc. shall inspect the condition of the facility before the end of the contract period to verify that the facility has no defect, as part of handover of maintenance and operation to the administrator, etc.
4. Relationship with the warranty for non-conformity to the contract
- In case of both BOT and BTO schemes, non-conformity of the facility after the delivery to the administrator, etc. is considered a problem of the warranty for non-conformity to the contract.
(Related: 2-4-3 Non-conformity of the Facility to the Contract)

4. Payment, etc. of the Service Consideration

4-1 Classification of PFI Projects by Method of Collecting the Project Cost

- The operation method of PFI projects can be generally classified into (1) a method in which the selected project is implemented based on usage fees collected from users; (2) a method in which the selected project is implemented based on the service consideration paid by the administrator, etc. for the public service (design, construction, maintenance, and operation of the facility) provided by the appointed business using the facility, when the appointed business is unable to collect usage fees from users; and (3) a method combining both.
 - When implementing the selected project by (2) or (3), it is necessary to provide for matters such as the structure of the service consideration and the method of payment, reduction, and revision, etc.
 - When implementing the selected project by (1) or (3), it is necessary to provide for matters such as the setting and revision of the usage fees.

4-2 Payment of the Service Consideration

1. Outline

- Provide that the administrator, etc. shall have the obligation to pay the appointed business a certain amount of money as a price for providing the public service that meets that required standards (content and quality) by designing, building, maintaining, and operating the facility in accordance with the PFI project contract, bid instructions, etc., and bid proposal (hereinafter, the service consideration). (Related: 1-6 Application of Provisions)

2. Provisions of applicable laws and regulations

- The Basic Policy provides that it is necessary to “provide for the content and quality of the service provided by the appointed business; the method of measuring and evaluating the service standards; the price and calculation method, etc.; the details of obligations borne by both contract parties to the contract, and the implementation method; proper and reasonable measures required for rehabilitation of the selected project, recovery of non-performance of obligations, and remedial measures, etc. for the contract parties when the contract parties breach provisions of the project contract.”
- The Cabinet Order on Budgets also provides that a contract must include the particulars of the timing and method of payment or reception of the contract price (Article 100, paragraph (1), item (ii) of the Cabinet Order on Budgets).
- The Act on Prevention of Delay in Payment also has similar provisions (Article 4, item (ii) of the Act on Prevention of Delay in Payment).¹

3. Viewpoint on the service consideration

- The service consideration may be considered as follows. (Reference: Guideline for Monitoring)
 - 1) That the construction costs, maintenance costs, and operation costs required for provision of public service are inseparable as the service consideration.
 - 2) That the amount equivalent to each cost item borne by the appointed business (construction costs, interest payment, maintenance costs, and operation costs, etc.) is paid separately as part of the service consideration.
- The amount of the service consideration is often indicated in a calculation formula, which is usually detailed in an appendix of the PFI project contract.

4. Payment procedure

- As explained above, it is common to provide that the service consideration shall be paid every three months (four times a year) or every semester (two times a year).

¹ When a local government is the administrator, etc., provisions of Article 14 of the Act on Prevention of Delay in Payment apply *mutatis mutandis*.

- The payment of the service consideration in each term follows the following procedure: (1) the administrator, etc. verifies the situation of performance of work by the appointed business during the term and notifies the appointed business thereof; (2) in case of default or deficiency, etc. the administrator, etc. applies and finalizes the price reduction measures set forth in advance and notifies the appointed business thereof; (3) in case of ambiguities, the administrator, etc. and the appointed business hold consultation; (4) the appointed business claims the service consideration for the term, calculated based on the notification from the administrator, etc.; and (5) the administrator, etc. pays the service consideration. It is also common to provide for opportunities of reparation or a certain grace period for the appointed business before finalizing the price reduction.
 - It is also possible to provide that, if the payment date falls on a closed day (holidays of administrative organs set forth in the Act on Holidays of Administrative Organs, etc.), the payment, etc. shall be made before that date.
5. Return of the service consideration in case of false reports
- It is common to provide that, when false information is contained in the work reports submitted by the appointed business to the administrator, etc., the appointed business shall have the obligation to return the unjustly obtained amount from the service consideration received (Article 703 of the Civil Code). The amount to return is often set as the amount of the service consideration that would have been reduced if it were not for the false information. The appointed business has the obligation to return the unjustly obtained amount regardless of whether false reports were intentional or by negligence. It is also possible to provide that, when the appointed business intentionally makes false reports, the appointed business shall be liable for damage (Article 704 of the Civil Code), and if the extent is severe, etc., the administrator, etc. shall obtain the right to cancel.

4-3 Reduction of the Service Consideration

1. Outline

- Provide that, when the situation of performance of work by the appointed business is found to not meet the required business level or conform to the PFI project contract as the result of the monitoring (supervision (measurement and evaluation) of the standards of the service provided by the appointed business), the administrator, etc. shall reduce the service consideration or suspend its payment. (Reference: Guideline for Monitoring)

2. Purpose

- By providing for measures such as reduction of the service consideration and suspension of payment by the administrator, etc., it is possible to give the appointed business an economic motive to perform work properly. When the payment of the service consideration is suspended, the appointed business is not paid for interest or delay charges from the administrator, etc. and newly incurs interest, which serves as an economic motive.

3. Price reduction, etc. procedure

- When it is found that the maintenance and operation work during the service consideration payment term does not meet the required business level as the result of the verification by the administrator, etc. (related: 3-4 Work Reports), the administrator, etc. notifies the appointed business of the matters to improve, sometimes specifying the correction period. Or, when it is found to not meet the required standards as the result of the service standards measurement by the appointed business, the appointed business may take improvement measures on its own. It is usual to provide that, when the public service provided by the appointed business does not meet the required business level even after the correction period, the service consideration shall be reduced or its payment suspended at the first payment date that comes after it.

(Price reduction method)

- In case of price reduction, the amount of reduction may be calculated (1) by dividing the service consideration by the number of days the facility could not be used, or (2) based on the penalty point rules set forth in advance when the service standards are not improved even after the correction period.

(Handling of the amount of reduction from the next term: suspension of payment)

- When the service consideration is reduced, the amount of reduction is not usually paid even after the service standards improve. However, in some cases, when payment of all of the service consideration is suspended, a certain percentage of the service consideration suspended in the previous term (equivalent to the reduced service consideration) may be paid in addition to the service consideration for the current term, on condition of recovering more than a certain level of service standards in the following "service consideration payment period."

(When the service standards do not improve even after the following term)

- It is possible to provide that, when the service standards do not improve even after the next term, the administrator, etc. shall obtain the right to cancel (after sending a notice for correction, etc.).
4. Reduction of the service consideration equivalent to the construction costs
- There are following viewpoints regarding whether the reduction of the service consideration applies even to the service consideration equivalent to the construction costs. One of the viewpoints is that the design, construction, maintenance, and operation of the facility are considered as a single work for which the service consideration is paid, and the service consideration equivalent to the construction costs is also subject to reduction so as to give the appointed business a strong economic motive to maintain the service standards. However, after the construction of the facility is verified to be complete and the ownership of the facility is transferred to the administrator, etc., it is considered better to exempt the service consideration for the construction of the facility from the reduction as a liquidated claim and give the appointed business an economic motive to maintain the public service standards by paying the service consideration equivalent to the maintenance and operation. However, this does not preclude off-setting the compensation from cancelling out the damages incurred by the administrator, etc. due to non-performance of obligations.

4-4 Revision of the Service Consideration

1. Outline

- Provide that the service consideration shall be revised regularly depending on the increase or decrease in the costs of the appointed business due to price and interest rate fluctuations, etc.
- When technologies essential to the implementation of the selected project are expected to advance, provide that the required business level and the service consideration shall be revised to respond to the technological advancement.

2. Purpose

- Since price and interest rate fluctuations, etc. may increase the costs or decrease the profits of the appointed business in a long-term PFI project, consider the impact of the fluctuations, etc. on the selected project (Risk Guidelines II 6 (2)) and provide for regular revision of the service consideration. In this case, it is necessary to provide for matters such as the items subject to revision in the service consideration, economic and financial indices on which revision will be based, calculation formulas for the revision, and the timing, etc. of the revision.
- When technologies essential to the selected project are expected to advance considerably, the real price of the goods and services, etc. significantly decreases due to obsolescence of technologies. In such case, it may be reasonable to revise the service consideration depending on the technological advancement.

3. Revision due to price fluctuations

- Price indices used as the standards for revision of the service consideration include the corporate service consideration index, real wage index, consumer price index, wholesale price index, and construction price index (applicable to repair cost). The above indexes may be applied according to each work or cost item subject to the revision.
- As for the price index to be used as the standard for revision of the service consideration, an index that accurately reflects the market price of goods and services employed by the appointed business can be selected to reduce the risk of price fluctuations borne by the appointed business.
- The service consideration may be revised regularly (every year or every three years in most cases) regardless of the level of fluctuations of the indexes used, or only when the indexes used fluctuate more than a certain level.

4. Revision due to interest rate fluctuations

- The appointed business usually procures funds at a fixed interest rate based on an interest rate swap, and most transactions in today's interest rate swap market are for 15 years maximum. Therefore, when the loan period is more than 15 years, it is common to reflect the future interest rate fluctuations in the service consideration. To reflect the risk of interest rate fluctuations in the revision of the service

consideration, the service consideration may be revised based on the fixed interest for the remaining period after 10 years pass, or for the next five years every five years. When the risk of interest rate fluctuations is not reflected in the revision of the service consideration, the risk is borne by the appointed business, but it is necessary to note that it may be reflected in the financial costs and the contract price if the interest rate rises. When the loan amount is relatively small, the costs of practical procedure by the contract parties may be also taken into account to decide whether to revise the service consideration depending on the interest rate fluctuations.

5. Revision of Reduction of the service consideration or enjoyment of improvement of performance due to technological advancements
 - When considerable technological advancements are expected in the technological field essential to the selected project during the contract period (or when significant obsolescence is expected during the contract period), it is possible to provide that, if the appointed business becomes able to perform maintenance and operation that meet the initially required business level at a lower cost due to the technological advancements, the administrator, etc. or the appointed business shall request to revise the reduction of the service consideration upon consultation with the other party. To give the appointed business an economic motive regarding the proposal of the reduction, a part of the amount of reduction proposed by the appointed business may be reflected in the profit of the appointed business, instead of all of it being deducted from the service consideration.
 - The administrator, etc. may benefit from advantages of technological advancements by improving the required business level instead of reflecting it in the service consideration.
 - In any case, when considerable technological advancements are expected in the technological field essential to the selected project during the contract period, the contract parties need to determine the allocation of advantages of technological advancements upon consultation.

4-5 Matters Relating to Usage Fees When the Selected Project is Implemented Based on Usage Fees Collected from Users

1. Outline
 - When the appointed business receives usage fees, provide that the appointed business may collect usage fees as its revenue. Also provide for the method of setting and revising, etc. the usage fees.
2. Collection of usage fees
 - Provide that the appointed business shall collect usage fees in a specific facility, etc.
3. Setting and revision of usage fees
 - Provide that the appointed business may set or revise the usage fees within a reasonable and appropriate scope, taking into account the following:
 - that the usage fees do not unjustly discriminate specific people;
 - that the usage fees are not significantly inappropriate in light of social and economic situations and do not harm the benefit of users of the public facility, etc.
 - When there are provisions regarding fees in relevant individual acts, provide that the appointed business shall set or revise the usage fees in accordance with these provisions and upon following the prescribed procedures.
 - Provide that, before following procedures relating to the setting and revision of the usage fees, the appointed business shall consult with the administrator, etc., obtain approval of the administrator, etc., or notify the administrator, etc.
 - It is also possible to provide for conditions of revising the usage fees.
 - It is also possible to provide that, when the appointed business notifies the administrator, etc. of the setting or revision of the usage fees, and if the usage fees are not found to be within a reasonable and appropriate scope, the administrator, etc. may request consultation with the appointed business regarding the fees.
4. Measures when proper and reliable provision of public service is not ensured
 - It is possible to provide for penalties, etc. as a measure to be taken when proper and reliable provision of public service is not ensured despite collection of reports and conducting surveys, etc. The procedure in this case may be based on “4-3 Reduction of the Service Consideration.”

5. Termination of the Contract

- A PFI project contract may terminate when the contract period ends or when it is cancelled during the contract period. Cancellation of the PFI project contract may be for reasons attributable to the appointed business (the administrator, etc. has the right to cancel; explained in “5–1 Right to Cancel of the Administrator, etc. of the Public Facility, etc.”), for reasons attributable to the administrator, etc. (the appointed business has the right to cancel; explained in “5–2 Right to Cancel of the Appointed Business”), and due to force majeure or changes in laws and regulations. When the PFI project contract is cancelled, the contract parties have the obligation to pay damages or penalties, etc. (explained in “5–4 Effect of Cancellation” and “5–5 Penalties”).
- The Basic Policy provides that a PFI project contract “must provide for appropriate and reasonable measures required for restoring the selected project, cure of non-performance of obligations, and remedial measures, etc. for the contract parties when a contract party breaches provisions of the project contract (Basic Policy IV 4 (2))” and “must specifically and clearly provide for measures required for restoring the project when it is possible to restore the project and reasonable to continue to the project, depending on attributable reasons (Basic Policy IV 4 (6)).” Therefore, provide that, even when a contract party does not perform its obligations under the PFI project contract, if it is possible to restore the project and reasonable to continue to the project, the contract parties and related parties shall restore the selected project. Also provide for appropriate and reasonable measures, etc. required for the restoration.
- Therefore, a PFI project contract provides for the right to cancel the contract (Article 540, paragraph (1) of the Civil Code). By providing for the right to cancel the contract, it becomes possible to complement or modify the grounds and conditions for the statutory right to cancel, or to provide for other grounds and conditions for cancellation, in order to ensure proper and reliable implementation of selected projects.

5-1 Right to Cancel of the Administrator, etc. of the Public Facility, etc.

1. Outline

- Provide that, when the appointed business does not perform its obligations under the PFI project contract, the administrator, etc. may demand the appointed business to perform within a certain period, and if non-performance is not corrected even after that period, the administrator, etc. may cancel the PFI project contract. However, provide as a special provision that, when the breach of the contract by the appointed business is of nature that destroys the trust between the appointed business and the administrator, etc., and if non-performance is not expected to be corrected despite the demand, the administrator, etc. may cancel the contract without demand.

2. Purpose

- Provide that, when the appointed business does not perform its obligations under the PFI project contract, the administrator, etc. may basically demand the appointed business to perform within a certain period, and if non-performance is not corrected after that period, the administrator, etc. may cancel the PFI project contract. When non-performance is corrected within that period, the administrator, etc. may not cancel the PFI project contract. Since it is important to continuously provide the public service in accordance with the PFI project contract, it is necessary to give the appointed business an economic motive to correct its non-performance (cure the non-performance of obligations and restore the project) before the administrator, etc. exercises its right to cancel. However, provide as a special provision that, when the breach of the contract by the appointed business is extremely of nature that destroys the trust between the appointed business and the administrator, etc., and if non-performance is not expected to be corrected despite the demand, the administrator, etc. may cancel the contract without demand.
- The Basic Policy provides that a PFI project contract must “list grounds that hinder continuation of the project as specifically as possible, and specifically and clearly provide for measures to be taken by the contract parties when such grounds arise or are found to be highly likely to arise, depending on the existence of attributable reasons” and “specifically and clearly provide for measures required for restoring the project when it is possible to restore the project and reasonable to continue the project, depending on the existence of attributable reasons” (Basic Policy IV 4 (6)). It is strongly recommended to specifically and clearly provide for grounds for cancellation, as well as measures, etc. to be taken by the contract parties when the grounds for cancellation arise or are highly likely to arise.

3. Grounds for cancellation

- A long-term PFI project contract is based on a relationship of trust between the contract parties, and it is necessary to agree in advance on what actions are considered as non-performance of obligations and what procedure the other party has to follow to cancel the PFI project contract. Conditions for cancellation due to non-performance of obligations are clearly provided for from such perspective. It is also common to provide for grounds for cancellation that do not require establishment of non-

performance of obligations which is a statutory ground for cancellation, from the viewpoint of ensuring proper and reliable implementation of selected projects. (Related: 7 Voluntary Cancellation)

- The Basic Policy provides that a PFI project contract must provide for grounds for condition subsequent of a project contract specifically and clearly and list grounds that hinder continuation of the project as specifically as possible (Basic Policy IV 4 (6) and (7)). It is necessary to strictly provide for grounds for cancellation by the administrator, etc.
- Examples of grounds for cancellation are as follows:

(1) Delay in starting the design or construction work

- The design or construction work is the first step to achieving the aim of the PFI project contract. Delaying its start beyond the scheduled date is expected to strain the whole process and have a major negative impact, etc. on the quality of the facility. Since it is not possible to anticipate the provision of public service in accordance with the PFI project contract, etc. despite maintaining the contractual relationship, the delay in starting the design or construction work is considered a ground for cancellation by the administrator, etc.
- Specifically, when the appointed business does not start the design or construction work after the scheduled date and does not provide any reasonable explanation to the administrator, etc. despite a demand specifying a considerable period, the administrator, etc. obtains the right to cancel the PFI project contract. In some cases, when the appointed business delays the start of the design or construction work without a just cause, the administrator, etc. obtains the right to cancel the PFI project contract without making any particular demand.

(2) Delay in completion or delivery (or start of operation) of the facility

- When the appointed business delays the completion or delivery (or start of operation) of the facility essential to the provision of public service, and if the appointed business is not expected to perform it even after a certain period passes from the scheduled date (or the postponed scheduled date in case of postponement of the scheduled date of delivery (or start of operation)), it is impossible to anticipate the provision of public service despite maintaining the contractual relationship. Therefore, it is considered a ground for cancellation by the administrator, etc.

(In case of a selected project under BTO scheme)

- It is common to provide that, when the delivery is not possible or not clearly anticipated even after a certain period passes from the scheduled delivery date for reasons attributable to the appointed business, it shall be considered a ground for cancellation by the administrator, etc. In case of a selected project that focuses on the scheduled start date of operation, the scheduled start date of operation is set as the performance deadline instead of the scheduled delivery date, and when it is not possible to start the operation of the facility even after a certain period passes from the scheduled start date of operation, it may be considered a ground for cancellation by the administrator, etc.

(In case of a selected project under BOT scheme)

- It is common to provide that the following cases shall be considered grounds for cancellation by the administrator, etc. (1) With a focus on the construction completion of the facility, when the construction of the facility is not completed within the scheduled period, and if it is found that there is clearly no prospect of it being completed within a considerable period following the scheduled period for reasons attributable to the appointed business. (2) With a focus on the start time of the facility operation, when it is not possible to start the operation of the facility even after a certain period passes from the scheduled start date of operation, or when it is found that there is clearly no prospect of it for reasons attributable to the appointed business.

(3) Non-performance of obligations relating to maintenance and operation

- When non-performance of obligations relating to maintenance or operation by the appointed business persists for more than a certain period, it is not possible to anticipate the provision of public service in accordance with the PFI project contract, etc. despite maintaining the contractual relationship. Therefore, it is considered a ground for cancellation by the administrator, etc.
- A specific example of the cancellation procedure is as follows. In case of non-performance of obligations relating to maintenance or operation by the appointed business, the administrator, etc. may do the following while reducing or suspending the payment of the service consideration for non-performed obligations:
 - 1) When non-performance of obligations is repeated more than a specified level, the appointed business strengthens and improves the performance on its own.
 - 2) The administrator, etc. demands the appointed business to take improvement measures and submit an improvement plan, and the appointed business improves the performance based on the agreed improvement plan.
 - 3) When non-performance of obligations is not improved after the improvement and correction period, and if more than a specified level of non-performance of obligation continues, the administrator, etc. shall obtain the right to cancel after a certain period following the demand.

(Related: 4-1 Payment of the Service Consideration, 5-4 Effect of Cancellation/ Reference: Guideline for Monitoring)

(4) Bankruptcy of the appointed business

- When the appointed business starts a procedure for bankruptcy, corporate reorganization, civil rehabilitation, company liquidation, or special liquidation, or resolves on a petition for a similar procedure at a meeting of the Board of Directors, or such a petition has been made by a third party, the appointed business is bankrupt to a level where it is unable to continue and restore the selected project. Therefore, it is considered a ground for cancellation by the administrator, etc.
- It is possible to provide that, when direct causes of bankruptcy or matters suggesting bankruptcy arise, such as when the appointed business becomes insolvent, suspends payments, or delays

performance of obligations of over a certain amount beyond a certain number of days, and if it is judged that achieving the aim of the PFI project contract is probably impossible, the administrator, etc. shall obtain the right to cancel before the establishment of non-performance of obligations by the appointed business.

(5) Abandonment of the project by the appointed business

- When the appointed business abandons the project for a certain period, continuing the selected project by the appointed business is expected to be impossible. Therefore, it is considered a ground for cancellation by the administrator, etc.

(6) Other breaches of the contract

- When the appointed business breaches the PFI project contract, and if it is found that achieving the aim of the PFI project contract is impossible due to the breach, it is impossible to anticipate the provision of public service despite maintaining the contractual relationship. Therefore, it is considered a ground for cancellation by the administrator, etc. Significant falsification of the work reports by the appointed business is a major breach of the contract that destroys the relationship of trust, and therefore a ground for cancellation by the administrator, etc.

4. Setting of the correction period

- Provide that, when the appointed business does not perform obligations despite the demand from the administrator, etc. to perform obligations within a certain correction period, the administrator, etc. may cancel all or a part of the PFI project contract. For the correction period, it is necessary to set a period that the appointed business is expected to need for correcting the non-performance of obligations. To ensure the stability of the contractual relationship, it is desirable to specifically and clearly provide for the correction period for each ground for cancellation.

5. Step-in by the lending financial institution, etc.

- When a ground for cancellation without demand arises, or when a specific correction period passes without the non-performance being corrected despite a demand from the administrator, etc., the administrator, etc. obtains the right to cancel the PFI project contract. However, if the administrator, etc. judges it necessary to continue the selected project, the administrator, etc. may retain the exercise of the right to cancel and hand over the selected project to a third party approved by the administrator, etc. and the lending financial institution, etc. Such step-in by the lending financial institution, etc., which has an interest in continuing the selected project, allows the administrator, etc. to not only achieve the continuous and stable provision of public service, but also find a third party qualified for taking over the selected project using information, etc. of the lending financial institution, etc. and appoint it by a proper procedure. In this case, the lending financial institution, etc. is expected to intervene in the selected project in accordance with the direct agreement and use its security interests

in shares, etc. issued by the appointed business or other assets to allow a third party, which is appointed by the administrator, etc. upon recommendation from the lending financial institution, etc., to take over the selected project by obtaining the shares or other assets. (Related: 6-1 Disposition of Rights and Obligations of the Appointed Business)

- The Basic Policy provides that the administrator, etc. “shall make appropriate arrangement in advance in an agreement, etc. within a scope reasonable for ensuring the continuous provision of public service from the viewpoint of the public nature and fairness, when a third party such as the financial institution demands the selected project to be taken over due to failure of the appointed business, based on the financial structure composed at the responsibility of the appointed business” (Basic Policy IV 2 (9)). For the administrator, etc., it may be meaningful to provide for step-in by the lending financial institution, etc. within a reasonable scope, since it is likely to allow it to maintain the continuous and stable provision of public service, although it prevents the exercise of the right to cancel. As for the period during which the administrator, etc. retains the exercise of the right to cancel, it is necessary to set a reasonable period for finding a third party that takes over the project.

6. Significance of the direct agreement

- The direct agreement may be abbreviated as D/A.
- Regarding the direct agreement, the Basic Policy provides that the administrator, etc. “shall make appropriate arrangement in advance depending on the situation of the selected project, while taking into account the protection of the rights of the lending financial institution, etc. such as the secured claims, when the selected project fails, or when it is judged appropriate to directly negotiate the disposition of the project and assets between the administrator, etc. of the public facility, etc. and the lending financial institution, etc.” (Basic Policy IV 2 (8)).
- The direct agreement is an agreement concluded between the administrator, etc. and the lending financial institution, etc. and provides for matters necessary for allowing the lending financial institution, etc. to demand the administrator, etc. to retain the exercise of the right to cancel the PFI project contract, and step in the selected project using the security interests relating to the selected project, when it is difficult or expected to be difficult for the appointed business to continue the selected project.
- A PFI project contract differs from a general contract for public work in the fact that not only the appointed business which is a party to the contract but also the lending financial institution, etc. bear the financial risks of the project. If there is no contractual relationship between the administrator, etc. and the lending financial institution, etc. which both share the risks relating to the PFI project, the lending financial institution, etc. might stop providing funds and dispose of the project assets, etc. by the exercise or compulsory execution of its interest rights without approval of the administrator, etc. in order to preserve its claims. The administrator, etc., which aims at the continuous and stable provision of public service by continuing the project, wants to avoid such situation from arising. Therefore, the direct agreement between the administrator, etc. and the lending financial institution, etc. is also

meaningful for the administrator, etc., since it allows the administrator, etc. to make arrangement in advance regarding the suspension of funding or exercise of security interests by the lending financial institution, etc. and give the lending financial institution, etc. an opportunity to step in to restore the project. Conclusion of the direct agreement does not preclude the administrator, etc. from directly restoring the project. Also, when the administrator, etc. and the lending financial institution, etc. do not expect the project to be restored within a period specified in the direct agreement despite the step-in of the lending financial institution, etc., the administrator, etc. may cancel the PFI project contract.

- As of today, a direct agreement for a PFI project of Japan is expected to mainly provide for the following:
 - 1) Approval of the administrator, etc. regarding the establishment of the security interests in the rights of the appointed business under the PFI project contract, shares issued by the appointed business, and project assets by the lending financial institution, etc.;
 - 2) Notification from the lending financial institution, etc. to the administrator, etc. when the appointed business has concerns regarding the protection of claims owned by the lending financial institution, etc. such as grounds for loss of the benefit of time under the loan agreement;
 - 3) Notification from the administrator, etc. to the lending financial institution, etc. when there are grounds for cancellation attributable to the appointed business under the PFI project contract;
 - 4) Consultation in case of 2) or 3);
 - 5) Involvement of the administrator, etc. in case of step-in by the lending financial institution, etc. using the security interests (such as consultation with the administrator, etc. before the exercise of the security interests, etc.);
 - 6) Prior notification to the administrator, etc. when one of the lending financial institution, etc. transfers the loan receivable from the appointed business under the loan agreement to a third party; and conclusion of a direct agreement between the administrator, etc., the lending financial institution, etc., and the third party with a content similar to the previous agreement.
- To avoid a situation where the appointed business, which expects the administrator, etc. to retain the exercise of the right to cancel, does not know that the PFI project contract is cancelled without step-in by the lending financial institution, etc., the appointed business may become a party to the direct agreement in addition to the administrator, etc. and the lending financial institution, etc., or provide signature or the name and seal to prove that it has verified the content of the direct agreement between the administrator, etc. and the lending financial institution, etc.
- The direct agreement may also provide for the procedure for selecting, etc. a third party that takes over the selected project from the appointed business. (Related: 6-1 Disposition of Rights and Obligations of the Appointed Business)
- When a third party newly becomes the lending financial institution, etc. by the transfer of claims (above 6)), and if there is a procedure required for the transfer of claims (i.e. advanced approval, etc. of the administrator, etc. for the appointed business to conclude a status transfer reservation agreement with the new creditor under the PFI project contract), the administrator, etc. must give as much

consideration as possible to make the procedure smooth so that it does not hinder the project operation by the appointed business.

7. Voluntary cancellation

- It is common to provide that, when the selected project is no longer needed, or conversion of the facility is needed for reasons such as changes in policies of the administrator, etc. or requests of residents, the administrator, etc. may cancel the PFI project contract voluntarily by notifying the appointed business of the cancellation before a certain period. This provision aims to add a condition for the right to cancel by the administrator, etc. based on the particularity that the selected project aims at providing public service and that it is useless to provide what is not needed in society. However, voluntary cancellation by the administrator, etc. is an unpredictable risk for the appointed business, and the administrator, etc. needs to carefully consider the scope and amount of compensation for damage to be claimed by the appointed business before exercising this right.

8. Principle of documentary proceeding

- It is desirable to provide that demands and notifications or notices of termination of the PFI project contract from the administrator, etc. to the appointed business shall be in writing, from the viewpoint of avoiding conflicts later.

5-2 Right to Cancel of the Appointed Business

1. Outline

- Provide that, when the administrator, etc. delays the payment of the service consideration and does not perform the obligation of payment even after a certain period passes from reception of a demand from the appointed business, and when it becomes difficult for the appointed business to implement the selected project due to a major breach of obligations by the administrator, etc., and if such situation continues despite a demand specifying a correction period from the appointed business, the appointed business may cancel the PFI project contract.

2. Purpose

- In order to ensure the stability of the contractual relationship, this provision aims to clarify the conditions for statutory cancellation by the appointed business due to non-performance of obligations by the administrator, etc.

3. Conditions and effect of cancellation

- As in the case of cancellation of the PFI project contract for reasons attributable to the appointed business, it is necessary to clarify the conditions for cancellation of the PFI project contract for reasons attributable to the administrator, etc. and specify a certain correction period to ensure the stability of the contractual relationship.
- Even if the appointed business is unable to properly perform work during the correction period set for the administrator, etc., it is for reasons attributable to the administrator, etc., and therefore the service consideration should not be reduced. It is also possible to provide that, when the administrator, etc. does not perform the obligation to pay the service consideration, the obligation of the appointed business to maintain and operate the facility during the correction period set for the administrator, etc. shall be reduced or minimized in order to reduce the expenditure of the appointed business, and the service consideration shall be charged accordingly.
- Provide that, when the administrator, etc. delays the payment of money, the administrator, etc. shall pay delay charges in addition to the due amount. (Related: 6-3 Delay Charges)
- It is desirable to also provide that demands for payment and notifications of termination of the PFI project contract from the appointed business to the administrator, etc. shall be in writing from the viewpoint of avoiding conflicts later.

5-3 Right to Cancel Due to Force Majeure, etc.

1. Outline

- Provide that, when all or a part of performance of work by the appointed business becomes impossible for reasons not attributable to any of the contract parties such as force majeure and changes in laws and regulations, the administrator, etc. may cancel all or a part of the contract upon discussion with the contract parties.

2. Exercise of the right to cancel due to force majeure or changes in laws and regulations

- For the definition of force majeure, see “2-2-9 Damage Due to Force Majeure (Design and Construction Phase).”
- Provide that, when it becomes impossible to perform the construction, maintenance, or operation in accordance with the PFI project contract, etc. due to force majeure or changes in laws and regulations, the contract parties shall hold consultation for a certain period to discuss matters such as the allocation of costs for additional personnel or equipment, etc. required for meeting the initial required business level, and changes to the required business level or PFI project contract, etc.
- If an agreement is not reached within a certain consultation period, the administrator, etc. shall notify the appointed business of the method for addressing the force majeure or changes in laws and regulations, and the appointed business shall continue the selected project accordingly. However, as financially unreasonable situation of the continuity of the selected business may be expected; when the impossibility of performance of the selected project is judged to be permanent, or when excessive costs are required for continuing the selected project. In such cases, the administrator, etc. may cancel a part or all of the PFI project contract upon consultation with the appointed business.
- It is necessary to consider whether the right to cancel a part or all of the PFI project contract due to force majeure, etc. is given only to the administrator, etc. or both contract parties. (Related: 2-2-9 Damage Due to Force Majeure (Design and Construction Phase), 3-6 Damage Due to Force Majeure (Maintenance and Operation Phase))
- As for the effect of cancellation of the PFI project contract due to force majeure, it is possible to provide that the administrator, etc. shall purchase the facility and bear the price of the facility and other reasonable costs incurred by the appointed business. Other reasonable costs may include costs required for commencement and disbandment of the appointed business.
- It is common to provide that, when performance of work by the appointed business becomes impossible for reasons such as defects in the project land or discovery of buried cultural properties, the same measures as in the case of the impossibility of performance due to force majeure, etc. shall be taken.

3. Exemption from performance of obligations due to force majeure or changes in laws and regulations, and payment of the service consideration

- When it becomes impossible for the appointed business to perform all or a part of obligations due to force majeure or changes in laws and regulations, after sending a notification of the details and reasons for the impossibility of performance to the administrator, etc., the appointed business is exempted from performance of obligations within a scope affected by the force majeure or violating the applicable laws and regulations during the time the impossibility of performance continues and until consultation is arranged. The administrator, etc. usually deducts the costs saved by the appointed business due to the impossibility of performance and pays the service consideration for other work performed. (Related: 6–6 Obligation to Take Out Insurance)
4. Allocation of damage, etc. due to force majeure
- Provide that, after the appointed business sends a notification of impossibility of performance due to force majeure, if the administrator, etc. decides to continue the selected project, and if an agreement is not reached within a certain period in the aforementioned consultation between the contract parties regarding measures such as the allocation of damage or additional costs due to force majeure, the administrator, etc. shall notify the appointed business of measures such as the prescribed allocation of damage, etc. and the appointed business shall act accordingly. (Related: 2–2–9 Damage Due to Force Majeure (Design and Construction Phase) and 3–6 Damage Due to Force Majeure (Maintenance and Operation Phase))
5. Allocation of additional costs due to changes in laws and regulations
- Provide that, after the appointed business sends a notification of impossibility of performance due to changes in laws and regulations, if the administrator, etc. decides to continue the selected project, and if an agreement is not reached in a certain period in the aforementioned consultation between the contract parties regarding measures such as the allocation of additional costs due to changes in laws and regulations, the administrator, etc. shall notify the appointed business of measures such as the prescribed allocation of additional cost, and the appointed business shall act accordingly.
 - Regarding the allocation of additional costs for responding to the changes in laws and regulations, it is common to specify laws and regulations in advance that are directly related to the selected project, and provide that the administrator, etc. shall bear additional costs due to changes in such laws and regulations, while the appointed business shall bear additional costs due to changes in laws and regulations other than those specified in advance that widely affect private businesses in general. However, it is possible to give consideration to the fact that, while a private company can avoid additional costs due to changes in laws and regulations at its own discretion by withdrawing, etc. from the field of business affected, the appointed business may have narrower discretion compared to normal companies due to the particular nature of its obligation under the PFI project contract which is to provide the public service.
 - As for the allocation of additional costs due to changes in the tax system, it is common to provide that the administrator, etc. shall bear additional costs due to changes to the consumption tax rate applicable

to the service consideration. It is possible to also provide that the administrator, etc. shall bear additional costs due to changes to the tax rate applicable to the assets owned and due to establishment of a new tax. It is common to provide that the appointed business shall bear additional costs, etc. due to changes to taxes applicable to profits of the appointed business, such as changes to the corporate tax rate.

6. Benefit of cost reduction due to changes in laws and regulations

- It is possible to provide that, when changes in laws and regulations allow the appointed business to perform the design, construction, maintenance, and operation that meet the prescribed required business level at a lower cost, the administrator, etc. shall request the reduction of the service consideration upon consultation with the appointed business. In any case, the contract parties need to consult about how to share the benefit of cost reduction due to changes in laws and regulations.

5-4 Effect of Cancellation

1. Outline

- The effects when a PFI project contract is canceled are as follows: (1) the handling of the obligation to restore to the original state, specifically the handling of various assets depending on the progress of the selected project, and (2) the obligation, etc. to pay compensation for damage incurred due to cancellation.

2. Purpose

- In the PFI project contract, the obligation to restore to original condition imposed on the appointed business as the effect of cancellation, reasonable handling of the facility, etc. as the effect of cancellation. If so, it will be difficult to rationalize the facility, etc. after the cancellation. Therefore, provide for the effect of cancellation according to the characteristics of each selected project.

3. Effect of cancellation for reasons attributable to the appointed business – Cancellation before completion of the facility –

- Provide that, when the PFI project contract is cancelled before completion of the facility, and if the administrator, etc. judges it appropriate to continue the construction work using the completed parts of the facility after this, instead of restoring to the original state, or if it is found to be reasonable under the general societal terms to purchase the completed parts, for example, in the case where the construction work of the facility is advanced, the administrator, etc. may purchase the completed parts from the appointed business at a reasonable price, and modify the provisions regarding the effect of statutory cancellation (imposition of the obligation to restore the original condition) in an agreement. When deciding on this kind of purchase, it is necessary to note that (1) it may be difficult to identify who is responsible for non-conformity to the contract when a third party continues the construction work over the completed parts; (2) in particular, in case of a selected project that emphasizes operation, it is necessary to make judgement from the viewpoint of the convenience of the third party taking over the project; and (3) if the appointed business is required to demolish the completed parts and restore it to the original state, the start of providing public services may be delayed more than when continuing the construction work using the completed parts, and it is necessary to consider the impact of the delay.
- Regarding the procedure of purchasing the completed parts of the facility by the administrator, etc., it is common to provide that the administrator, etc. shall inspect the facility and receive the delivery of the parts that pass the inspection; that the administrator, etc. may select between the lump sum or installment payment of the price under the PFI project contract; and that, in case of the installment payment, the administrator, etc. shall make payments according to the prescribed schedule. At the same time, under the loan agreement concluded between the appointed business and the lending financial institution, etc., the appointed business loses the benefit of time due to the cancellation, and the lending financial institution, etc. obtains the right to demand a lump-sum repayment to the appointed business. Therefore, when deciding on the method of payment of the facility's purchase

price, consultation may be held based on the direct agreement, etc. If the installment payment is selected, the administrator, etc. is able to minimize the fiscal expenditure.

- When the purchase price is paid directly from the administrator, etc. to the lending financial institution, etc., without involving the appointed business, upon consultation based on the direct agreement, etc., it may be considered the payment no longer a project risk, but a credit risk of the administrator, etc. As explained above, when the installment payment is selected, it may be considered of changing the conditions for payment of the price including the amount equivalent to interest paid (in case of the national government, revising the interest rate level to reflect the yield level of government bonds during the payment period) based on the new credit decision by the lending financial institution, etc.
 - It is necessary to note that, even when the PFI project contract imposes on the administrator, etc. the obligation to purchase the facility, and if it has the obligations that exceeds the expenditure budget for the fiscal year concerned, the purpose of the already voted action for bearing deficits in the Treasury, or the maximum period and amount of the debt burden, a new resolution on the expenditure or action for bearing deficits in the Treasury is necessary at the time of cancellation.¹
 - The amount paid by the administrator, etc. to purchase the completed parts of the facility is usually the amount equivalent to the piece rate of the facility based on the design drawings.
 - Provide that, when it is judged inappropriate to purchase the completed parts of the facility, the administrator, etc. may demand the appointed business to demolish the facility and restore the project land to the original state. Provide that the costs for this shall be borne by the appointed business or the administrator, etc. depending on the responsibility for cancellation, and when the appointed business does not restore the original state within a certain period without a just reason, the administrator, etc. may restore it to the original state on its own and claim the costs from the appointed business, since it is not financially reasonable to leave the facility as is. In this case, the appointed business shall not file an objection to the disposition taken by the administrator, etc., since it is the result of the appointed business not taking the disposition it should take.
 - Also provide for the obligation of the appointed business to pay penalties to the administrator, etc. (Related: 5–5 Penalties, 6–5 Performance Guarantee)
4. Effect of cancellation for reasons attributable to the appointed business – Cancellation after completion of the facility –
- In case of a selected project under BTO scheme, the administrator, etc. already possesses the ownership of the facility after its completion, it is common to provide that the administrator, etc. shall obtain and retain the ownership of the facility when the contract is cancelled under BOT scheme. In case of a selected project under BTO scheme, it is necessary to verify that the condition of maintenance of the facility meets the required standards, and in case of a selected project under BOT

¹ When a local government is the administrator, etc., acquisition or disposal of assets prescribed in ordinances in accordance with the standards prescribed in cabinet orders regarding the kind and price, except for those prescribed in Article 96, paragraph (1), items (vi) and (vii) of the Local Autonomy Act, shall be voted for at the local council pursuant to provisions of Article 96, paragraph (1), item (viii) of the same Act.

scheme, it is necessary to inspect the facility before the transfer and verify that it is in a condition that does not hinder the agreed use (related: 3–7 Inspection Before the End of the Contract Period). It is necessary to provide that, when the condition of the facility is found to not meet the prescribed standards as a result of inspection, the appointed business shall pay the necessary repair costs to the administrator, etc. or carry out the necessary repairs, in addition to paying the facility's purchase price and penalties, etc. explained later.

- In case of a selected project under BOT scheme, the facility's purchase price is usually the unpaid amount of the principal and interest of construction costs (in case of installment payment).
- As for the payment method for the facility's purchase price after cancellation, it is common to provide that the administrator, etc. may select either the lump-sum or installment payment, and that, in case of the latter, the administrator, etc. shall make payments according to the longest prescribed schedule. At the same time, under the loan agreement concluded between the appointed business and the lending financial institution, etc., the appointed business loses the benefit of time due to cancellation of the PFI project contract, and the lending financial institution, etc. obtains the right to demand lump-sum repayment to it. Therefore, when deciding on the method of payment, consultation may be held based on the direct agreement, etc. If the installment payment is selected in the consultation, the administrator, etc. is able to minimize the fiscal expenditure.
- When the purchase price is paid directly from the administrator, etc. to the lending financial institution, etc., without involving the appointed business, upon consultation based on the direct agreement, etc., it is possible to consider that the payment is no longer a project risk but a credit risk of the administrator, etc. As explained above, when the installment payment is selected upon negotiations, it is possible to consider changing the conditions for payment of the price including the amount equivalent to interest paid (in case of the national government, revising the interest rate level to reflect the yield level of government bonds during the payment period) based on the new credit decision by the lending financial institution, etc.
- It is necessary to note that, even when the PFI project contract imposes on the administrator, etc. the obligation to purchase the facility, the administrator, etc. must bear the expenditure or obligations exceeding the expenditure budget for the fiscal year concerned, which is the purpose of the already voted action for bearing deficits in the Treasury, or the maximum period and amount of the debt burden. A new resolution on the expenditure or action for bearing deficits in the Treasury is necessary at the time of cancellation.¹
- Also provide for the obligation of the appointed business to pay penalties to the administrator, etc. (Related: 5–5 Penalties, 6–5 Performance Guarantee)

¹ When a local government is the administrator, etc., Article 96, paragraph (1), item (viii) of the Local Autonomy Act provides that acquisition or disposal of assets prescribed in ordinances in accordance with the standards prescribed in cabinet orders regarding the kind and price, except for those prescribed in provisions of Article 96, paragraph (1), items (vi) and (vii) of the same Act, shall be voted for at the local council.

5. Effect of cancellation for reasons attributable to the administrator, etc.¹

- Provide that, when the PFI project contract is cancelled for reasons attributable to the administrator, etc., the administrator, etc. shall obtain the ownership of the facility and pay the amount equivalent to the piece price of the facility or the unpaid construction costs and its interest (in case of installment payment) depending on whether the facility has been completed or not. It is common to provide that in addition to the price for the completed parts or the facility, the appointed business shall obtain the right to claim damages including financial costs incurred due to the cancellation (premature repayment fees paid to the lending financial institution, etc.). (Related: 5-3 Right to Cancel Due to Force Majeure, etc.)
- It is necessary to note that even when the PFI project contract imposes on the administrator, etc. the obligation to purchase the facility, the administrator, etc. must bear expenditure or obligations that exceed the expenditure budget for the fiscal year concerned, the purpose of the already voted action for bearing deficits in the Treasury, or the maximum period and amount of the debt burden. A new resolution on the expenditure or action for bearing deficits in the Treasury is necessary at the time of cancellation.²
- Regarding the scope of compensation for damage, Article 416 of the Civil Code provides that damage that would ordinarily arise due to non-performance of obligations (within a scope of considerable causation) must be compensated for, and the obligor may also claim compensation for any damage under special circumstances which the other party should have foreseen. Based on this provision, the scope of compensation for damage is interpreted to include not only the costs already paid by the appointed business but also the profit the appointed business would have earned if not cancelled. However, the specific scope included (i.e. a few months' worth of the service consideration which was to be paid by the administrator, etc. if it were not for cancellation, among the lost profit) needs to be considered by the contract parties.

¹ When a local government is the administrator, etc., Article 96, paragraph (1), item (xiii) of the Local Autonomy Act provides that the amount of damages under its legal obligation shall be voted for at the local council.

² When a local government is the administrator, etc., Article 96, paragraph (1), item (viii) of the Local Autonomy Act provides that acquisition or disposal of assets prescribed in ordinances in accordance with the standards prescribed in cabinet orders regarding the kind and price, except for those prescribed in provisions of Article 96, paragraph (1), items (vi) and (vii) of the same Act, shall be voted for at the local council.

5-5 Penalties

1. Outline

- In order to ensure performance of obligations by the appointed business, provide for matters such as (1) the obligation of the appointed business to pay penalties to the administrator, etc. when the PFI project contract is cancelled for reasons attributable to the appointed business, and the amount of penalties; (2) the relationship between penalties and damages, adjustment between performance guarantee insurance and penalties, and whether it is possible to set off monetary obligations of the administrator, etc. against penalties.

2. Provisions of related laws and regulations

- Accounting laws, etc. provide that a contract shall include the particulars of damages, etc. in case of non-performance of obligations (Article 29-8, paragraph (1) of the Accounting Act; Article 100, paragraph (1), item (iv) of the Cabinet Order on Budgets; and Article 4, item (iii) of the Act on Prevention of Delay in Payment¹).

3. Amount of penalties

(Before completion of the facility)

- Based on Article 55, paragraph (2) of the Standard Contract Terms [note], it may be possible to provide that the amount of penalties to be paid by the appointed business to the administrator, etc. in case of cancellation for reasons attributable to the appointed business before completion of the facility shall be 1/10 (or 1/5 in some cases) of the price equivalent to the construction costs.

(After completion of the facility)

- Following examples show the amount of penalties to be paid by the appointed business to the administrator, etc. in case of cancellation for reasons attributable to the appointed business after completion of the facility:
 - 1) A certain percentage of the remainder of the construction costs, such as 1/10 (or 1/5 in some cases) of the total of the remainder of the construction costs borne by the appointed business and its interest;
 - 2) A certain percentage of the maintenance and operation costs which would have been paid to the appointed business, such as 1/10 (or 1/5 in some cases) of the price for the maintenance and operation costs for the remaining contract period or 1/10 (or 1/5 in some cases) of the price for the maintenance and operation costs for one project year cancelled.
- It is necessary to set an appropriate amount of penalties, taking into account that (1) the expected amount of damage incurred by the administrator, etc. due to cancellation varies by the contents, etc. of the selected project; (2) while an excessively small amount reduces the economic motive of the

¹ When a local government is the administrator, etc., provisions of Article 14 of the Act on Prevention of Delay in Payment apply mutatis mutandis.

appointed business to continue the project, an excessively large amount increases the funding cost, which may be reflected in the contract price.

- When the amount of penalties is set depending on the remaining contract period at the time of cancellation, if the amount of penalties is decreased depending on the remaining contract period as explained in 2) above, the amount of penalties will be higher earlier in the contract period, and it is possible to give the appointed business a relatively strong economic motive to perform obligations in the early phase which is not usually profitable. However, it is necessary to note that it may narrow down the scope of the loan by the lending financial institution, etc.

4. Relationship between penalties and damages

- Provide for the relationship between penalties and damages. Penalties are assumed to be liquidated damages unless otherwise clearly provided in the contract (Article 420, paragraph (3) of the Civil Code). Therefore, the legal consequence in this case is that the administrator, etc. is able to eliminate the difficulty of claiming damages, since it is able to claim without having to prove the occurrence and amount of damage. It is also necessary to note that limiting the damages, which can be a large amount in some cases, makes the risk calculation easy for the appointed business, and this may have an impact on the project costs of the appointed business and therefore on the contract price.
- It is also possible to clearly provide in a PFI project contract that penalties are not liquidated damages, and when the actual amount of damage incurred by the administrator, etc. exceeds the amount of penalties, the administrator, etc. may additionally claim the exceeding amount. (Related: 5-4 Effect of Cancellation)

5. Adjustment between performance guarantee insurance and penalties

- Provide that, when a performance guarantee insurance policy is taken out for the construction work of the facility with the administrator, etc. as the insured, and if the administrator, etc. receives the paid out insurance proceeds, the insurance proceeds shall be appropriated for penalties. When the administrator, etc. is insured under the performance guarantee insurance, this provision makes adjustments between the penalties and performance guarantee insurance proceeds so that the administrator, etc. does not receive both. (Related: 6-5 Performance Guarantee)
- Provide that, when performance guarantee insurance is taken out with the appointed business as the insured, the administrator, etc. shall establish the right of pledge on the insurance proceeds claims paid out by the performance guarantee insurance policy taken out by the appointed business at its own cost in order to guarantee the payment of penalties, and that the right of pledge shall have the requirements for assertion against third parties.

6. Set-off between monetary obligations of the administrator, etc. and penalties

- When the administrator, etc. incurs damage due to non-performance of obligations by the appointed business, the former claims damages from the latter. However, in the maintenance and operation phase

of a selected project under BTO scheme, there may be no asset of the appointed business against which the administrator, etc. is able to effectively guarantee damages. In this case, the administrator, etc. may obligate the appointed business to take out performance guarantee insurance in lieu of exemption from the contract deposit. (Related: 6-5 Performance Guarantee)

- To allow the administrator, etc. to receive damages even when it exempts the appointed business from the contract deposit and when maintenance and operation are not covered by performance guarantee insurance, the service consideration payable to the appointed business and the damages payable by the appointed business may be set off against each other to ensure the reception of damages (Article 505, paragraph (1) of the Civil Code).
- However, the lending financial institution, etc. usually establishes the right of pledge or mortgage by transfer on the claim for the service consideration. When the right of pledge or mortgage by transfer is established on the claim for the service consideration, the administrator, etc. is unable to resort to the set-off method. When a claim for the service consideration is transferred, the obligor may assert against the transferee (the lending financial institution, etc.) with a ground for asserting against the transferee, the appointed business by the time of fulfilling the requirements for assertion regarding the transfer of the claim (i.e. when the administrator, etc. gives approval), and the obligor may assert against the transferee by setting off the claim against the claim obtained prior to fulfilling the requirements for assertion (i.e. when the administrator, etc. gave approval). Even when the claim against the transferee has been obtained after the obligor fulfilled the requirements for assertion (i.e. when the administrator, etc. gave the approval), if the claim had arisen based on a cause that occurred before fulfillment of the requirements for assertion or based on the contract which caused the claim obtained by the transferee to arise, the obligor may assert against the transferee by setting off the claim (Articles 467, 468, and 469 of the Civil Code). Therefore, for example, even when non-performance of obligations by the appointed business occurs after the administrator, etc. gives approval for the transfer of the claim for the service consideration to the lending financial institution, etc., the administrator, etc. may be able to equally set off the claim for damages incurred due to the non-performance of obligations by the appointed business against the service consideration payable. It may also be possible to provide that when the claim for the service consideration is pledged as collateral to the lending financial institution, etc., the administrator, etc. may equally set off the service consideration payable against the damages borne by the appointed business even after the claim for the service consideration is mortgaged by transfer, etc. in order to receive damages by set-off. In this case, also provide for the procedure of consultation in advance.
- To make sure that the administrator, etc. collects its claims, it is also necessary to take measures such as requiring the appointed business to pay the contract deposit or take out performance guarantee insurance for maintenance and operation.
- At the same time, it is necessary to note that such measures have an impact on the possibility of funding and its costs of the appointed business.

5-6 Affairs at the End of the Contract

1. Outline

- When the administrator, etc. plans to continue using the facility after the PFI project contract ends by completion of the project period or cancellation, provide for matters such as (1) the removal of properties owned by the appointed business from the facility and its verification by the administrator, etc.; (2) handover, etc. of affairs and all documents necessary for the affairs from the appointed business to the party taking over the project. When the administrator, etc. plans to end the project, provide for matters such as removal of the facility and the obligation to restore the original state, etc.

2. Removal of properties and its verification

- In order not to hinder the continuous use of the facility by the administrator, etc. or a party designated by the administrator, etc. after the project ends, provide for removal of properties such as equipment owned by the appointed business (including properties owned by the entrusted/contracting companies, etc.) from the facility and its verification by the administrator, etc. It is also possible to provide for the allocation of costs required for removal of properties and handover of affairs explained in 3. (it is usually borne by the appointed business).
- In the same way as for restoration of the project land to the original state, it is possible to provide that when the appointed business does not remove its properties within a considerable period without a just reason, the administrator, etc. may do the same on its own and claim the costs from the appointed business. It is also possible to provide that the administrator, etc. may purchase properties owned by the appointed business, etc. upon consultation.

3. Handover of affairs and all documents necessary

- Provide that, after the PFI project contract ends, the appointed business shall hand over the maintenance and operation to the administrator, etc. or a party designated by the administrator, etc. so that it can smoothly take over the project. In case of a project that puts an emphasis on the maintenance and operation, when training of new personnel, etc. is necessary in addition to handover of work and necessary documents such as manuals, etc. it is necessary to consider setting a period for it before the PFI project ends.
- It is common to provide that all documents relating to the construction work and repair of the facility including design drawings and as-built drawings, as well as all documents necessary for maintenance and inspection shall be handed over by the appointed business to the administrator, etc. or to its designated party designated by the administrator, etc. From the viewpoint of smoothly handing over the project, it is also good to specify the documents to hand over.

6. Other Matters

6-1 Disposition of Rights and Obligations of the Appointed Business

1. Outline

- Provide for disposition of rights and obligations of the appointed business under the PFI project. Provide that unless otherwise approved in advance by the administrator, etc., the appointed business (1) shall not transfer or mortgage its rights and obligations under the PFI project contract to a third party or dispose of them in other ways; (2) shall not issue shares, share options, and bonds with share options; and (3) shall not merge with another corporation, etc.

2. Transfer of right and obligations, etc. of the appointed business

- The appointed business is a party appointed to implement the selected project pursuant to Article 8, paragraph (1) of the PFI Act (Article 2, paragraph (5) of the PFI Act), and a third party to which the rights and obligations of the appointed business under the PFI project contract are transferred must be appointed as the new appointed business by the administrator, etc. in order to implement the selected project. Therefore, provide that the transfer of rights and obligations under the PFI project contract by the appointed business must be approved in advance by the administrator, etc.
- The administrator, etc. may approve the transfer of rights and obligations of the appointed business under the PFI project when the former obtains the right to cancel the PFI project contract, judges it reasonable to restore the selected project by stepping in of the lending financial institution, etc., and judges it appropriate to allow a private business recommended by the lending financial institution, etc. to implement the selected project.
- The administrator, etc. may also approve the transfer of shares of the appointed business when the administrator, etc. expects personal and material supports of the transferee to restore the selected project by allowing the lending financial institution, etc. to transfer the shares of the appointed business to a third party using the security interests in shares of the appointed business; when the transferee is not included in the negative list for transfer of shares; or when the transfer of shares is within a scope already allowed under the PFI project contract, etc. In this case, only the funding structure of the corporation of the appointed business changes, and the status of the appointed business remains the same, thus the other party to the PFI project contract remains unchanged. It is possible to provide that a post-transfer notification from the transferor and transferee to the administrator, etc. shall suffice. (Related: 6-2 Transfer of Shares of the Appointed Business; Basic Agreement 4. and 5.)
- Regarding the transfer of obligations, the appointed business usually funds the selected project at its own responsibility, and when there is a procedure required for the transfer of obligations, the administrator, etc. should pay utmost attention to make the procedure smooth so that it does not hinder the project operation by the appointed business. (Related: 1-7 Funding by the Appointed Business; 5-1 Right to Cancel of the Administrator, etc. of the Public Facility, etc.)

- Provide that the establishment of security interests in rights and obligations under the PFI project must be approved in advance by the administrator, etc. The lending financial institution, etc. usually gives a project finance loan to the appointed business on the condition that it establishes security interests in the project assets and the obligations of the appointed business under the PFI project contract, etc. and agreements with consortium member companies or entrusted/contracting companies as collateral for repayment. By establishing these security interests, the lending financial institution, etc. expects to recover the loan not by selling the collateral but by continuing to restore the project; as the secured creditor, it aims to have priority over other creditors and make them lose the benefit of seizing assets, etc. of the selected project, in order to eliminate the intervention of third parties and securely recover the loan through smooth continuation of the project. Even if the project reaches a dead end, the lending financial institution, etc. may transfer these rights and obligations, etc. to a third party replacing the appointed business and seek possibilities of continuing the project by the third party. It is common to provide that the administrator, etc. shall conclude a direct agreement with the lending financial institution, etc. and approve the establishment of these security interests within a scope that is deemed to not infringe the benefit of the administrator, etc. such as smooth implementation of the selected project and maintenance of the public service standards. (Related: 5-1 Right to Cancel of the Administrator, etc. of the Public Facility, etc.)
- Considering that the SPC established by the consortium has been selected as the appointed business as a party having the performance ability conforming to the proposal upon evaluation of the proposal and performance ability in the public tender, provide that the merger with another corporation or issuance of new shares, etc. to a third party by the appointed business must be approved by the administrator, etc. when it is judged necessary to verify whether the appointed business has the same performance ability afterwards as at the time of selection. (Related: Annex "Basic Agreement")
- In particular, careful consideration must be given to the merger of the appointed business with another corporation, from the viewpoint of "ensuring the independence of the legal personality of the corporate entity in charge of the project or the independence of business units in terms of separate accounting" (main clause of the Basic Policy).

6-2 Transfer of Shares of the Appointed Business

1. Outline

- Provide for the transfer of shares of the appointed business by consortium member companies. Specifically, provide for matters such as the period in which the transfer is allowed or not, the percentage of transferable shares, and the conditions for approving or rejecting the transferee.

2. Basic stance on the transfer of shares

(1) Basic stance

- In past PFI projects, consortium member companies were often required to be shareholders of the appointed business (SPC) and be entrusted with or contracted for the selected project. As projects are expected to diversify and increase in scale, the allocation of shareholder responsibilities and operational responsibilities by different parties, etc. is considered to contribute to helping more businesses to take on PFI projects, enhancing the competition, and revitalizing the infrastructure market, which will benefit both the administrator, etc. and private businesses.
- Considering that the SPC established by the consortium is selected as the appointed business having the performance ability conforming to the proposal evaluated by the consortium and the performance ability of the consortium member companies and entrusted/contracting companies, it is necessary to guarantee that the appointed business has the same performance ability during the project period as at the time of selection; however, the transfer of shares, etc. does not necessarily have to be restricted, and the consortium member companies do not need to be shareholders of the appointed business (SPC) during the whole project period. For example, in case of a selected project involving construction of a facility, etc. when one of the consortium member companies is a construction company in charge of the construction, it is possible to clarify in the PFI project contract, etc. that the construction company may transfer its shares of the SPC after a certain period following the construction of the facility, etc.

(2) Specific procedure, etc.

- Methods and conditions for ensuring the same performance ability as at the time of selection vary depending on the type, content, and phase of the project. Conditions for the transfer of shares and other details should be determined by the administrator, etc. accordingly.
- When the administrator, etc. decides to set conditions for the transfer of shares, clearly indicate matters such as the policy on the transfer of shares, the period in which the transfer is allowed or not, the percentage of transferable shares, and conditions regarding the transferee in the implementation policy, bid instructions, application requirements, etc. to the extent possible depending on the project phase. It is desirable to also clarify the minimum requirements for proper implementation of the project depending on the role each private business should play in the selected project.
- When the articles of incorporation provide for the issuance of non-voting shares and its schedule, it is possible to set no particular procedure or condition for the transfer of non-voting shares.

- When a creditor can own shares of the appointed business by exercising the bonds with share options, it is necessary to note that it has to meet the same requirements as for the transfer of shares. For example, if the creditor can own shares of the appointed business by transferring shares to a new shareholder or executing the bonds with share options upon exercising the security interests and step-in rights based on the borrowing method selected by the appointed business, the creditor needs to meet the same requirements as for the transfer of shares.
- Regarding the application of provisions on the transfer of shares during the project period, it is possible to provide, etc. that only post-transfer notification, and not approval in advance, is necessary when the transferee is not included in the negative list or when the transfer takes place within a permitted scope.
- The administrator, etc. should give consideration to the benefit of related parties such as the facility users and private businesses and make sure that the transfer of shares is done properly and smoothly. Taking into account that the transfer of shares helps more businesses to take on PFI projects and revitalizes the infrastructure market, the administrator, etc. needs to ensure the public service standards, project continuity, and proper profit standards by clearly indicating the required standards, strengthening the monitoring of the appointed business, and providing for cancellation of the contract when the required standards are not met for reasons attributable to the appointed business.
- Before the transfer of shares, it may be necessary to take measures such as changing the joint guarantor in performance guarantee insurance (related: 6-5 Performance Guarantee), contract guarantee, and other performance guarantee measures. For example, when a shareholder of the appointed business (SPC) is the guarantor in the performance guarantee insurance policy, etc. the new shareholder to which shares are transferred needs to have the same performance guarantee capacity as the existing shareholder and follow necessary procedures for the transfer of shares.

6-3 Reporting of Business Situation

1. Outline

- Provide that the administrator, etc. shall request the appointed business to report the financial situation by submitting financial documents audited by a certified public accountant, in order to verify that the appointed business is financially capable of continuously providing the public service. (Reference: Guideline for Monitoring)

2. Purpose

- The Basic Policy provides that the administrator, etc. may "request the appointed business to regularly submit reports on performance of its obligations under the project contract" and "request the appointed business to regularly submit financial reports audited by a certified public accountant, etc. (within a scope that may affect the selected project)" (Basic Policy IV 4 (1) (b) and (c)).
- The Risk Guidelines provide that the administrator, etc. and the appointed business "shall, while minimizing the involvement of the appointed business, agree in advance on the status report 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." (Risk Guidelines III 5).
- Even when the appointed business properly carries out maintenance and operation, its financial situation of the appointed business may become bad, resulting in non-performance of its obligations by the appointed business or other grounds for cancellation of the PFI project contract. Therefore, provide that the administrator, etc. shall request the appointed business to report its business situation by submitting financial documents audited by a certified public accountant, etc., with the aim of regularly (once or twice a year, etc.) checking the financial situation of the appointed business within a scope that may affect the selected project. For example, it is possible to obligate the appointed business to submit the business plan, etc. for the next fiscal year before the final day of each fiscal year, disclose financial documents prescribed in the Companies Act, and submit financial documents audited by a certified public accountant within a certain period from the final day of each fiscal year, in line with the approval and reporting schedule of the Shareholders' Meeting. Also provide that the administrator, etc. may disclose the audited financial documents or their overview.

3. Survey on an as-needed basis

- The Basic Policy provides that "when a circumstance that may have a major negative impact on the selected project arises, the administrator, etc. may request the appointed business to make a report, carry out an inspection by a third-party expert, and submit the inspection report (Basic Policy IV 4 (3) (d)).
- It is therefore possible to provide that in addition to requesting the appointed business to regularly submit audited financial documents, the administrator, etc. may designate a certified public accountant

to inspect its financial situation of the appointed business, with the aim of speedily and firmly identifying circumstances that would negatively impact the selected project.

4. Purpose of an audit by a certified public accountant

- Provide that the appointed business shall submit financial documents audited by a certified public accountant to the administrator, etc. This means that regardless of the capital or the total amount of liabilities, the appointed business shall be subject to the same level of financial audit as a large company under the Companies Act (a corporation with capital of 500 million yen or more or liabilities of 20 billion yen or more in total) (Article 328 and Article 436, paragraph (2), item (i) of the Companies Act). The basic aim of the audit is to inspect whether financial documents, etc. correctly assess the company's financial assets, profits, and losses in accordance with laws and regulations and the articles of incorporation. Financial documents of a large company under the Companies Act which must be audited by a certified public accountant are financial statements and the annexed detailed statements prescribed in Article 435, paragraph (2) of the Companies Act, provisional financial statements prescribed in Article 441, paragraph (1) of the same Act, and consolidated financial statements prescribed in Article 444, paragraph (1) of the same Act (Article 396, paragraph (1) of the same Act).

6-4 Delay Charges

1. Outline

- Provide that when delaying the payments to be made under the PFI project contract, the administrator, etc. or the appointed business shall pay a certain percentage of the unpaid amount as delay charges to the other party.

2. Provisions of related laws and regulations

- Accounting laws, etc. provide that a contract shall include the particulars of interest for delay, etc. in case of non-performance of obligations by the contract parties (Article 100, paragraph (1), item (iv) of the Cabinet Order on Budget and Article 4, item (iii) of the Act on Prevention of Delay in Payment¹). Therefore, a PFI project contract provides for the amount, etc. of delay charges to be paid by the administrator, etc. to the appointed business or vice versa.
- Accounting laws provide that the amount of delay charges to be paid by the administrator, etc. to the appointed business must not be lower than the amount calculated at a rate specified by the Minister of Finance pursuant to Article 8 of the Act on Prevention of Delay in Payment (Article 8 of the Act on Prevention of Delay in Payment, Partial Revision of Interest Rate for Delay in Payment under Government Contracts (Ministry of Finance Announcement No. 54 of February 26, 2014)).
- In laws relating to management, etc. of claims made by the national government, damages and other money to be collected for delay in performance of monetary obligations of the national government are called delinquency charges. The amount of delinquency charges to be paid by the appointed business to the administrator, etc. must not be lower than the amount calculated at a rate specified by the Minister of Finance pursuant to Article 29, paragraph (1) of the Order for Enforcement of the Act on Management of Claims Held by the State and Other Matters (Article 35 of the Act on Management of Claims Held by the State and Other Matter; Article 36 of the Order for Enforcement of the Act on Management of Claims Held by the State and Other Matters Partial Revision of Rate Specified by the Minister of Finance Prescribed in the Main Clause of Article 29, paragraph (1) and Article 37, paragraph (1) of the Order for Enforcement of the Act on Management of Claims Held by the State and Other Matters (Ministry of Finance Announcement No. 129 of March 25, 2003)).

¹ When a local government is the administrator, etc., provisions of Article 14 of the Act on Prevention of Delay in Payment apply mutatis mutandis.

6-5 Performance Guarantee

1. Outline

- Provide that the appointed business shall have the obligation to pay a contract deposit or take out performance guarantee insurance in lieu of paying a contract deposit, etc. Matters to provide for regarding performance guarantee insurance are as follows.

2. Performance guarantee insurance for design and construction work

- Provide that the administrator, etc. shall obligate the appointed business to take out performance guarantee insurance to cover the costs required for re-ordering the construction work, etc., with the aim of guaranteeing the performance of obligations under the PFI project contract by the appointed business and preparing for cancellation of contract for non-performance of obligations by the appointed business during the construction period.
- Provide that (1) the appointed business shall conclude a performance guarantee insurance policy for the construction work of the facility with the administrator, etc. or the appointed business as the insured; (2) the appointed business shall conclude a performance guarantee insurance policy before starting the construction works of the facility and promptly submit the insurance certificate or its copy to the administrator, etc.; (3) the appointed business shall establish for the administrator, etc. a right of pledge on the claim for insurance proceeds pertaining to the performance guarantee insurance policy, taking as the secured claim for penalties the administrator, etc. obtains in case of cancellation of the PFI project contract for reasons attributable to the appointed business.

3. Performance guarantee insurance for maintenance and operation

- Whether the appointed business must take out performance guarantee insurance for maintenance and operation needs to be judged reasonably by the administrator, etc. at its own responsibility based on the applicable laws and regulations such as the Accounting Act, taking into consideration (1) that the service consideration is reduced by a prescribed procedure when the public service provided by the appointed business does not meet the required standards; (2) that penalties, etc. are imposed on the appointed business in case of cancellation of the contract for non-performance of obligations by the appointed business; and (3) whether it is feasible to collect penalties, etc. and other claims in case of cancellation. (Related: 4-2 Reduction of the Service Consideration, 5-5 Penalties)

4. Provisions of accounting laws, etc.

- The Accounting Act decides the contract deposit system in principle and provides that a contract officer, etc. shall (1) collect a contract deposit of ten percent or more of the contract price from a party that enters into a contract with the national government, as a means for guaranteeing perfect performance of obligations under the contract and for covering the damages (Article 29-9, paragraph (1) of the Accounting Act). It also provides that (2) securities such as government bonds and

guarantees from financial institutions, etc. may be provided in lieu of the contract deposit (Article 29-9, paragraph (2) of the Accounting Act; Article 100-4 of the Cabinet Order on Budget; Article 16 of the Contract Management Regulations) and (3) in cases such as when a performance guarantee insurance policy is concluded, the contract deposit may be exempted (proviso of Article 29-9, paragraph (1) of the Accounting Act; Article 100-3 of the Cabinet Order on Budget).¹

5. Details, etc. of performance guarantee insurance

- When requiring the appointed business to take out performance guarantee insurance for the construction work in lieu of payment of a contract deposit, it is common to provide that the insurance amount shall be 1/10 (or more in some cases) of the amount equivalent to the construction costs and that the insured period shall be the construction period.
- Performance guarantee insurance may cover the PFI project contract or the contract for work between the appointed business and the construction company. In case of the former, the administrator, etc. will be the insured; in case of the latter, the appointed business will be the insured, and the administrator, etc. will not have an insurance claim. Therefore, in case of the latter, it is necessary to provide that the administrator, etc. shall establish a right of pledge on the insurance claim by the appointed business.
- It is necessary to provide that the appointed business shall take out performance guarantee insurance upon verification of its details by the administrator, etc. and submit a copy of the insurance certificate to the administrator, etc.
- When requiring the appointed business to take out performance guarantee insurance during the maintenance and operation period, it is possible to provide that the insured period shall be one year to be renewed every year and that the insurance amount shall be 1/10 or more of the amount equivalent to the maintenance and operation costs for one project year. It is desirable that the administrator, etc. individually considers the details of performance guarantee insurance to be taken out by the appointed business by evaluating its performance ability and examining its effect and cost, while taking into account that the premiums of performance guarantee insurance may be reflected in the contract price.

¹ When a local government is the administrator, etc., Article 234-2, paragraph (2) of the Local Autonomy Act and Article 167-16 of the Order for Enforcement of the Local Autonomy Act provide for the contract deposit.

6-6 Obligation to Take Out Insurance

1. Outline

- Provide for the type and details of insurance that the appointed business takes out at its own cost or obligates the consortium member companies or entrusted/contracting companies, etc. to take out.

2. Purpose

- 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, recommended that a wide range of risk mitigation measures be studied at the appropriate time (Risk Guidelines 6 (1) Reference (3)) and to obligate the appointed business to take out insurance when it is judged reasonable to eliminate risks borne by both contract parties despite the insurance cost.

3. Type and details of insurance to take out

- Insurance that the appointed business has the obligation to take out varies by the project details, location, etc. Under both BTO and BOT schemes, performance guarantee insurance, construction work insurance, and third-party liability insurance, etc. are usually obligatory. In case of a selected project under BOT scheme in which the appointed business continues to own the facility after completion of construction, insurance related to the facility's property maintenance, such as fire insurance, is usually also obligatory.
- The administrator, etc. may indicate the details, etc. of insurance to be taken out by the appointed business in the bid instructions, etc., and make private businesses to propose other insurances. In this case, it is necessary to note that the administrator, etc. must obligate the appointed business to take out the insurance proposed.
- The PFI project contract provides for the type and details (insurance coverage, name of the insured, insurance period, insurance amount, etc.) of insurance to be taken out by the appointed business. Since the name of insurance varies by private insurance company, and new insurance products may be developed, it is desirable to allow the appointed business to select the most suitable insurance product from various products according to the purpose of insurance, instead of specifying a single insurance product.
- In case of a selected project under BTO scheme, after the delivery of the facility to the administrator, etc., the facility remains without fire insurance. The administrator, etc. takes out insurance such as mutual aid insurance and fire insurance from the private insurance companies, with the administrator, etc. as the insurer. Since a clause on non-exercise of the reimbursement claim is included in a fire insurance policy in accordance with the fire insurance general policy conditions and storekeepers' comprehensive insurance general policy conditions of private insurance companies, even when an event such as fire occurs for reasons attributable to the appointed business (tenant), the reimbursement

claim is not exercised from the private insurance company to the appointed business. However, this does not apply when it is by intention or by gross negligence of the appointed business.

- In case of a selected project under BOT scheme, the facility is covered by fire insurance during the maintenance and operation period, and it is necessary to pay attention to the handling of insurance proceeds in case of an event insured against. The lending financial institution, etc. usually establishes a security interest in the insurance claim. If an important part of the facility is damaged due to fire, the lending financial institution, etc. may consider it the end of the selected project, and will claim insurance proceeds to recover the loan, which would conflict with the claim of the administrator, etc. that aims to use the insurance proceeds to restore the facility and continue providing the public service. Therefore, it is desirable to provide for measures in such cases in the direct agreement.

4. Pros and cons of insurance obligation

- Regarding insurance that the appointed business is obligated to take out, it is usually appropriate to make the appointed business bear the risks of fires, storms, and floods which are generally covered by private insurance companies. As for earthquakes, volcanic eruptions, tsunamis, and terrorist attacks which are covered by insurance in a limited manner, as well as war, insurrection, and radioactive contamination which are not usually covered by insurance, requiring the appointed business to bear these risks that will make the funding difficult and increase the risk of bankruptcy of the appointed business. It is also necessary to consider that even when it is possible to obligate the appointed business to take out insurance, if insurance premiums are significantly high due to risks, etc. particular to the selected project, it will increase the project costs and may be reflected in the contract price.

5. Insurance procedure

- To allow the administrator, etc. to verify that the appointed business is performing the obligation to take out insurance, the appointed business shall take out insurance upon verification of its details by the administrator, etc. and submit a copy of the insurance certificate to the administrator, etc.
- The insurance period of performance guarantee insurance for maintenance and operation is usually a year in the current Japanese insurance market. If the insurance period is shorter than the period that needs to be covered, it is necessary to obligate the appointed business to renew the insurance policy based on the insurance period and submit a copy of the insurance certificate to the administrator, etc. after every renewal. It is also necessary to consider the allocation of additional costs in case of an increase in insurance premiums at the time of renewal.

6. Insurance taken out by third parties such as consortium member companies and entrusted/contracting companies

- Under the PFI project contract, all matters attributable to third parties entrusted with or contracted for work by the appointed business, such as consortium member companies, entrusted/contracting companies, and the subcontractors, are attributable to the appointed business, and it is therefore

desirable to provide that the appointed business shall take out insurance in principle. However, when the appointed business blanket orders design, construction, maintenance, and operation to third parties such as entrusted/contracting companies, it is possible to provide that the third parties such as the entrusted/contracting companies shall take out insurance.

- When providing that the third parties such as the entrusted/contracting companies shall take out insurance, each of the third parties may take out insurance separately, and the insurance coverage may not be sufficient, or the procedure in case of damage may be complex due to inspections carried out by multiple insurance companies. Therefore, when a project is expected to involve multiple entrusted/contracting companies, such as in a complex project or a project focused on operation, it is desirable to provide that the appointed business shall take out insurance.

6-7 Confidentiality Obligation

1. Outline

- Provide that the administrator, etc. and the appointed business shall not disclose confidential information of the other party learned during the performance of the PFI project contract to a third party.

2. Confidentiality obligation of the administrator, etc.

- Provide that the administrator, etc. shall not divulge any secret of the appointed business learned during the performance of the PFI project contract.
- Confidentiality obligation does not apply to information of the appointed business subject to information disclosure under applicable laws and regulations, etc. However, company secrets of the appointed business are not usually subject to disclosure.

3. Provisions of the Act on Access to Information

- The Act on Access to Information provides that the head of an administrative organ shall specify information which is required not to disclose as clearly and reasonably as possible, and shall disclose administrative documents pertaining to the disclosure request unless non-disclosure information is recorded in the administrative documents (Article 5 of the Act on Access to Information). A PFI project contract is a document prepared by employees of an administrative organ in the course of their duties and is for use by its employees, and is therefore considered an administrative document under the Act (Article 2, paragraph (2) of the Act on Access to Information). Therefore, when disclosure of a PFI project contract is requested, administrator, etc. shall disclose the PFI project contract to the applicant in principle. The Act on Access to Information also provides that information concerning a juridical person or other entities, or information concerning the business of an individual who operates the said business shall not be disclosed when the "information which when disclosed is likely to cause harm to the rights, competitive position, or other legitimate interests of the said Juridical Persons, etc. or of the said individual"(Article 5, item (ii), (a) of the Act on Access to Information), and therefore such information in a PFI project contract shall not be disclosed. However, it provides that, in the case that non-disclosure information is recorded in a part of an administrative document pertaining to a disclosure request, when it is possible to easily divide and exclude the portion in which the non-disclosure information is recorded, the administrator, etc. shall disclose to the applicant that particular portion (however, this shall not apply when it is found that no meaningful information is recorded in the portion like it is in the excluded portion) (Article 6, paragraph (1) of the Act on Access to Information). Whether particular information is "likely to cause harm" needs to be judged properly, taking into account the relationship between the appointed business and administrator, etc. based on the character, rights and interests, and nature of the appointed business.

4. Confidentiality obligation of the appointed business

- Provide that the appointed business shall not divulge any secret of the administrator, etc. learned during the performance of the contract or any personal information of the facility users and occupants, etc. For example, in case of construction works of a government building, etc. this provision prevents from divulging secrets because of security risks relating to the leak of the facility's design and construction works, etc.
 - For convenience of conclusion of contract and performance of obligations by the appointed business, administrator, etc. usually allows the appointed business to disclose certain information to (1) officers and employees of the appointed business; (2) experts who have confidentiality obligation under laws and regulations such as lawyers, accountants, and tax accountants, etc.; (3) consultants; and (4) the lending financial institution, etc. When the administrator, etc. and the lending financial institution, etc. conclude a direct agreement, it provides a confidentiality obligation of the administrator, etc. and the lending financial institution, etc.
5. Confidentiality obligation of third parties such as consortium member companies
- The appointed business may obligate the consortium member companies, entrusted/contracting companies, and subcontracting companies that perform the actual work to submit a confirmation letter providing that they shall not divulge any secret of the administrator, etc. or personal information of the facility users and occupants, etc. learned during the performance of the work.

6–8 Discussions on Ambiguities

1. Outline

- Provide that, when it is necessary to provide for matters not provided for in the PFI project contract, or when there are ambiguities regarding the interpretation of the PFI project contract, the administrator, etc. and the appointed business must hold consultation in good faith.

2. Purpose

- The PFI project contract aims to provide for all matters necessary for smooth implementation of the selected project. In light of this aim, it is necessary to provide for the rights and obligations of the contract parties as specifically and clearly as possible in the PFI project contract. Provide that the contract parties shall hold consultation in good faith when matters not provided for in the PFI project contract, such as risks not expected at the time of conclusion of the PFI project contract, and ambiguities regarding the implementation of the PFI project contract arise. It is also necessary to provide for the method of handling disputes relating to the contract in case when consultations fail and disputes occur between the contract parties (Article 4, item (iv) of the Act on Prevention of Delay in Payment¹ and Article 100, paragraph (1), item (vi) of the Cabinet Order on Budgets).

3. Establishment of a council of related parties

- It is possible to establish a council composed of the contract parties and other related parties as a body for holding consultation and provide for its members, organizational procedure, etc. in advance in the PFI project contract. It is also possible to provide in advance that a council for consultation of important matters and a council for detailed consultation regarding daily work shall be established based on the classification of matters of consultation by level of importance such as the impact on the allocation of risks between the contract parties.
- It is possible to provide for a procedure to seek opinions from experts, etc. and other third parties as a method of handling disputes relating to the PFI project contract.

¹ When a local government is the administrator, etc., provisions of Article 14 of the Act on Prevention of Delay in Payment apply *mutatis mutandis*.

6-9 Response to Damage Due to Force Majeure (Repeated)

1. Definition of force majeure

- Force majeure refers to external circumstances that are unrelated to the acts of parties to an agreement, etc. and are unpreventable despite taking care and prevention measures normally considered necessary. It can be categorized into natural disasters that are not attributable to the administrator, etc. or the appointed business such as storms, torrential rain, floods, high tides, landslides, cave-ins, lightening strikes, earthquakes, fires, and toxic gas, and human-made disasters such as riots, uprisings, war, and terrorist attacks. The final definition is determined by an agreement between the contract parties. (Reference: Risk Guidelines II 6 (1))

2. Outline (design and construction phase)

- To prepare for a case where it becomes impossible to perform the design and construction work in accordance with the PFI project contract, etc. due to force majeure during the design and construction phases, provide the matters such as the handling of obligations in case of force majeure, the procedure of notification, etc. from the appointed business to the administrator, etc. in case of impossibility of performance, and the allocation of damage, etc. due to force majeure and changes to the scheduled date of delivery (or start of operation) of the facility.

(1) Procedures in case of force majeure, etc.

- Provide that, when it becomes impossible to perform all or a part of the design and construction work in accordance with the PFI project contract, etc. due to force majeure, the appointed business shall immediately notify the administrator, etc. of the details and reasons of impossibility of performance in writing. After sending the notification of impossibility of performance, the appointed business is exempted from its obligation to perform work set forth in the PFI project contract, etc. within the scope affected by the force majeure while the impossibility of performance persists. However, the appointed business has the obligation to keep damage to a minimum.
- Provide that, upon receiving the notification of impossibility of performance from the appointed business, the administrator, etc. shall have the obligation to promptly carry out surveys to check the state of damage caused due to force majeure and notify the appointed business of the result. Also provide that the administrator, etc. shall hold consultation with the appointed business regarding measures such as changes to the design and construction work, etc. delay in delivery (or start of operation), and the allocation of reasonable damage and additional costs due to force majeure.
- Provide that, when an agreement is not reached in the above-mentioned consultation within a certain period, the administrator, etc. shall notify the appointed business of measures for continuing the project, and the appointed business shall have the obligation to continue the selected project accordingly. Also provide that, when the impossibility of performance by the appointed business is judged to be permanent, or when excessive costs are required to continue the selected project, the

administrator, etc. may cancel a part or the entire PFI project contract upon consultation with the appointed business regarding whether or not to continue the project. It is also possible to give the right to cancel to both the administrator, etc. and the appointed business.

(2) Allocation of damage, etc. due to force majeure

- In order to give the appointed business an economic motive to keep damage due to force majeure to a minimum, it is common to provide that, when the facility, temporary structures, construction materials already carried into the construction site, and other construction equipment, etc. are damaged due to force majeure during the design and construction phase, the appointed business shall bear a part of the damage or additional costs incurred, and the administrator, etc. shall bear the remainder. For example, it is possible to provide that the appointed business shall bear up to a certain percentage of the total construction costs during the period or up to a certain amount, and the administrator, etc. shall bear the exceeding portion within a reasonable scope. When considering the percentage of damage borne by the appointed business, it is necessary to note that the more damages the appointed business must bear, the larger the costs required for bearing the risks of force majeure becomes due to the impossibility of accurately quantifying the risks of force majeure and the insurance restrictions, which would result in the costs being reflected in the contract price. Also provide that the appointed business shall bear the damage, etc. caused due to its negligence of the duty of care of its manager.
- It is necessary to consider the scope of damage. Specifically, it is desirable to clarify whether the scope of damage is limited to active damage (damage of the facility and temporary structures, etc. only) or whether it includes related damage and additional costs in general incurred by the appointed business.
- It is common to provide that the administrator, etc. shall bear the damage or additional costs incurred due to force majeure within a reasonable scope of a certain percentage of the construction costs or the portion exceeding a certain amount. In this case, the appointed business is expected to also bear the damage, etc. incurred due to force majeure of a certain percentage of the construction costs or the portion exceeding a certain amount, and it is possible to provide for the allocation of damage as specifically as possible.
- A general contract for public work provides that the orderer shall bear the portion exceeding 1/100 of the contract price, thereby reducing the burden of the contractor (Article 30, paragraph (4) of the Standard Contract Terms). In this provision, the damage is allocated while taking into account the fact that the orderer also bears damage in some way instead of attributing all of it to the contractor, and from the viewpoint of eliminating unilateralism in contracts for work and promoting healthy development of the construction industry.

(3) Changes to the scheduled date of delivery (or start of operation)

- In addition to the allocation of damage incurred due to force majeure, it is necessary to consider postponing the scheduled date of delivery (or start of operation) to determine the scope of damage. The amount of damage (including additional costs, etc.) may be allocated without changing the

scheduled date of delivery (or start of operation) and on the condition that the appointed business completes the facility by that date, or the amount of damage (active damage only) is allocated upon postponing the scheduled date of delivery (or start of operation) for a reasonable period. The former option is selected if the priority is to start the operation of the facility by a certain date. In this case, the amount of damage to be borne is expected to be relatively high. In case of the latter, since the scheduled date of delivery (or start of operation) is postponed, the start of the service consideration payment will be delayed. It is therefore necessary to consider how the delay in the start of the service consideration payment may affect the loan repayment by the appointed business and the burden of the administrator, etc.

- Regarding the above, when the scheduled date of delivery (or start of operation) is postponed, it is necessary to consider whether the end date of the maintenance and operation period is also postponed, or whether the maintenance and operation period is shortened with the unchanged end date. In case of the former, the maintenance and operation period remains unchanged, but the payment of the service consideration is delayed overall. In case of the latter, it is necessary to consider the service consideration that the appointed business will lose as a result of the shortened maintenance and operation period. (Related: 1–4 Project schedule)

(4) Deduction of insurance proceeds from the allotted amount of damage, etc. due to force majeure

- It is common to provide that, when the appointed business receives insurance proceeds paid out by insurance policies relating to preservation of the facility for damage, etc. due to force majeure, and if the amount exceeds the amount of damage borne by the appointed business, the exceeding portion shall be deducted from the amount of damage, etc. borne by the administrator, etc.

3. Outline (maintenance and operation phase)

- To prepare for a case where it becomes impossible to maintain and operate the facility in accordance with the PFI project contract, etc. due to force majeure during the maintenance and operation phase, provide for matters such as the handling of obligations in case of force majeure, the procedure of notification, etc. from the appointed business to the administrator, etc. in case of impossibility of performance, and the allocation of damage, etc. due to force majeure.

(1) Procedures in case of force majeure, etc.

- Provide that, when it becomes impossible to perform all or a part of the design and construction work in accordance with the PFI project contract, etc. due to force majeure, the appointed business shall immediately notify the administrator, etc. of the details and reasons of impossibility of performance in writing. After sending the notification of impossibility of performance, the appointed business is exempted from its obligation to perform work set forth in the PFI project contract within the scope affected by the force majeure while the impossibility of performance persists. However, the appointed business has the obligation to keep damage to a minimum.

- It is possible to provide that, while the impossibility of performance persists, the administrator, etc. shall pay the appointed business for other work performed, deducting costs that the appointed business has avoided due to the impossibility of performance.
- Provide that, upon receiving the notification of impossibility of performance from the appointed business, the administrator, etc. shall have the obligation to promptly carry out surveys to check the state of damage caused due to force majeure and notify the appointed business of the result. Also provide that the administrator, etc. shall hold consultation with the appointed business regarding measures such as changes to the details of work, and allocation of reasonable damage and additional costs.
- When an agreement is not reached in the above-mentioned consultation within a certain period, the administrator, etc. notifies the appointed business of measures for continuing the project, and the appointed business has the obligation to continue the selected project accordingly. When the impossibility of performance by the appointed business is judged to be permanent, or when excessive costs are required to continue the selected project, the administrator, etc. may cancel a part or all of the PFI project contract upon consultation with the appointed business. It is also possible to give the right to cancel to both the administrator, etc. and the appointed business.

(2) Allocation of damage, etc. due to force majeure

- When damage is caused due to force majeure during the maintenance and operation period, it is necessary to give the appointed business an economic motive to keep the damage to a minimum. Therefore, it is common to provide that the appointed business shall bear responsibility for a part of damage or additional costs incurred due to force majeure, and the administrator, etc. shall bear the exceeding portion within a reasonable scope. The amount of damage, etc. borne by the appointed business may be:
 - 1) The total amount of damage, etc. during the maintenance and operation period, up to a certain percentage of the total maintenance and operation costs during the maintenance and operation period;
 - 2) The total amount of damage, etc. due to force majeure during one project year, up to a certain percentage of the maintenance and operation costs for one project year;
 - 3) A fixed amount.
- Also provide that the appointed business shall bear responsibility for damage incurred due to negligence of its duty of due care of a prudent manager.

4. Outline (exercise of the right to cancel due to force majeure)

- Provide that, when all or a part of performance of work by the appointed business becomes impossible for reasons due to force majeure, administrator, etc. may cancel all or a part of the contract upon consultation with the appointed business.

(1) Exercise of the right to cancel due to force majeure

- Provide that, when it becomes impossible to perform the construction, maintenance, or operation in accordance with the PFI project contract, etc. due to force majeure, the contract parties shall hold consultation for a certain period to discuss matters such as the allocation of costs for additional personnel or equipment required to meet the initial required business level, and changes to the required business level or PFI project contract, etc.
- If an agreement is not reached within a certain consultation period, administrator, etc. shall notify the appointed business of the method for addressing the force majeure or changes in laws and regulations, and the appointed business shall continue the selected project accordingly. However, as financially unreasonable situation of the continuity of the selected business may be expected; when the impossibility of performance is judged to be permanent, or when excessive costs are required for continuing the selected project. In such cases, administrator, etc. may cancel a part or all of the PFI project contract upon consultation with the appointed business.
- It is necessary to consider whether the right to cancel a part or the entire PFI project contract due to force majeure, etc. is given only to the administrator, etc. or to both the contract parties.
- As for the effect of cancellation of the PFI project contract due to force majeure, it is possible to provide that the administrator, etc. shall purchase the facility and bear the price of the facility and other reasonable costs incurred by the appointed business. Other reasonable costs may include costs required for commencement and disbandment of the appointed business.

(2) Exemption from performance of obligations due to force majeure, and payment of the service consideration

- When it becomes impossible for the appointed business to perform all or a part of obligations due to force majeure, after sending a notification of the details and reasons for the impossibility of performance to the administrator, etc., the appointed business is exempted from performance of obligations within a scope affected by the force majeure during the time the impossibility of performance continues and until consultation is arranged. The administrator, etc. usually deducts the costs saved by the appointed business due to the impossibility of performance and pays the service consideration for other works performed.

(3) Allocation of damage, etc. due to force majeure

- Provide that, after the appointed business sends a notification of impossibility of performance due to force majeure, if the administrator, etc. decides to continue the selected project, and if an agreement is not reached within a certain period in the aforementioned consultation between the contract parties regarding measures such as the allocation of damage or additional costs due to force majeure, administrator, etc. shall notify the appointed business of measures such as the prescribed allocation of damage, and the appointed business shall act accordingly.

Annex: Basic Agreement

1. Purpose of the basic agreement

- The basic agreement confirms that the consortium is the successful bidder, and provides for necessary matters regarding the obligations of administrator, etc. and the consortium member companies for conclusion of a PFI project contract between the corporation established by the consortium (which becomes the appointed business under the PFI project contract) and administrator, etc.
- The basic agreement clearly provides for matters such the establishment of a corporation and preparations, etc. for the selected project by the consortium member companies that successfully bid on the selected project.

(Establishment of a corporation by the consortium member companies)

- The consortium is the successful bidder of the PFI project, and the corporation established for the selected project concludes the PFI project contract with administrator, etc. as the appointed business. At the time of selection of the successful bidder, the counterparty to administrator, etc. does not exist yet, and the project scheme proposed by the consortium in the bid (funding of the corporation established by the consortium member companies, outsourcing of work from the appointed business to the consortium member companies, etc.) cannot be implemented. Therefore, it is necessary to make the consortium member companies establish a corporation which will conclude the PFI project contract.
- Administrator, etc., which is the orderer, concludes a PFI project contract, etc. with the corporation established by the consortium which is the successful bidder, providing that the corporation shall perform the selected project in conformity with the bid proposal. When such measure is expected to be taken, administrator, etc. must publicly clarify so in advance in the implementation policy and bid instructions, etc., from the viewpoint of ensuring fair competition between private businesses.

(Preparations for the selected project by the consortium member companies)

- After the consortium is selected as the successful bidder, the administrator, etc. and the consortium member companies hold consultation regarding the content of the PFI project contract to prepare for its conclusion. In practice, the appointed business which is a party to the PFI project contract is often established right before the conclusion of the PFI project contract, and the consortium member companies may start design preparations and other preparations necessary for the selected project before the conclusion of the PFI project contract on the premise that it will be concluded. Therefore, the appointed business needs to take over the responsibilities taken by the consortium member companies during the period from the selection of the successful bidder to the conclusion of the PFI project contract.
- Since the consortium is a "company in the course of incorporation" and does not have legal personality, its capacity to hold rights is not recognized; however, it is recognized that the "company in the course

of incorporation" and the established company are substantially the same, and is a procedure to formally transfer the rights and obligations under the name of the consortium member companies to the established corporation is taken.

2. Outline of the basic agreement

- In order to achieve the above purposes, the basic agreement provides that:
 - 1) the consortium member companies and administrator, etc. shall have the obligation to make efforts for conclusion of the PFI project contract;
 - 2) the consortium member companies shall have the obligation to establish a corporation;
 - 3) when it is judged necessary to ensure that the consortium member companies have the same performance ability as it is at the time of selection of the appointed business based on the character of the project, the consortium member companies shall be subject to restrictions on disposition such as the transfer of shares of the corporation;
 - 4) the consortium member companies shall have the obligation to entrust or contract the consortium member companies, etc. with works necessary for performance of the PFI project contract via the corporation;
 - 5) the consortium member companies shall have the obligation to make the newly established corporation and administrator, etc. conclude the PFI project contract by a specific date;
 - 6) the consortium member companies and the newly established corporation may make necessary preparations for the selected project and shall have the obligation to promptly hand over the results to the appointed business after conclusion of the PFI project contract;
 - 7) when conclusion of the PFI project contract fails, the consortium member companies and administrator, etc. shall bear their respective costs for the preparation.

3. Establishment of a corporation

- Based on the conditions administrator, etc. indicated in the bid instructions, application requirements, etc. depending on the type, content, and phase of the project, and the bid proposal of the successful bidder or the proposal of the preferred bidder, provide for matters such as the percentage, amount, and type of funding by the consortium member companies for the establishment of a corporation.
- The appointed business needs to guarantee that it has the same performance ability as at the time of selection of the appointed business during the project period, but it is not necessary to impose across-the-board restrictions such as the consortium member companies maintaining the control of the management until the end of the PFI project contract, and the necessity of restrictions on the transfer of shares depends on the content, phase, etc. of the project. It is desirable to keep the conditions and details of the transfer of shares to a minimum necessary for proper implementation of the project depending on the role of each consortium member company, and clearly specify them in advance in the implementation policy, bid instructions, application requirements, etc. within a scope possible in each phase.

- For example, the basic agreement may provide that:
 - (1) the consortium member companies or parties that continuously engage in the selected project shall have more than half of the total voting rights of the newly established corporation (voting rights required for passing of ordinary resolution by shareholders attending the general meeting of shareholders), and one of the consortium member companies shall be the largest shareholder; or
 - (2) the consortium member companies or parties that continuously engage in the selected project shall have more than two thirds of the total voting rights of the corporation which is the appointed business (voting rights required for passing of special resolution by shareholders attending the general meeting of shareholders).

However, it is necessary to note that the conditions and details of the transfer of shares are provided for depending on the project, and it is not prohibited to ease the conditions of the transfer more than the above examples. It may be beneficial for both administrator, etc. and the appointed business to make different parties bear shareholder responsibilities and operational responsibilities separately, taking into account the necessity of funding, etc.

- A special resolution at the general meeting of shareholders (Article 309, paragraph (2) of the Companies Act) is required for matters relating to fundamental changes to the company such as the transfer of business (Article 467, paragraph (1) of the same Act), the amount by which the stated capital is reduced (Article 447, paragraph (1) of the same Act), dissolution (Article 471, item (iii) of the same Act), amendments to the articles of incorporation (Article 466 of the same Act), and merger (Article 783, paragraph (1), etc. of the same Act).

4. Restrictions on disposition such as the transfer of shares, etc.

- Provide that, when transferring shares of the newly established corporation, establishing security interests, or taking other disposition, the consortium member companies must submit a request for disposition of shares to administrator, etc. and obtain its approval in advance. (Reference: 6–1 Disposition of Rights and Obligations of the Appointed Business; 6–2 Transfer of Shares of the Appointed Business)
- It is possible to provide that a post-transfer notification suffices when the transferee is not included in the negative list for the transfer of shares, or when the transfer of shares is in a scope permitted in light of related provisions, instead of providing for approval in advance. It is also necessary to make sure that the transfer of shares within the permitted scope is done properly and smoothly, taking into account the benefit of related parties such as the facility users and the appointed business.
- It is also possible to provide in the basic agreement that the articles of incorporation of the newly established corporation shall provide for restrictions on the transfer of shares pursuant to Article 107, paragraph (1), item (1) or Article 108, paragraph (1), item (iv) of the Companies Act. By providing so, the articles of incorporation provide that the transfer of shares shall require approval by a resolution of the general meetings of shareholders (meeting of the board of directors in case of a company with the board of directors).

5. Entrustment and contracting of work

- Provide that, when administrator, etc. indicates qualification requirements for the consortium member companies in the bid instructions, etc. and requires each of the consortium member companies to be entrusted with or contracted for work by the newly established corporation, each of the consortium member companies shall be entrusted with or contracted for work indicated in the bid proposal. In some cases, it is considered that parties entrusted with or contracted for the selected project do not necessarily have to be consortium member companies or entrusted/contracting companies during the whole project period, and that any party having the same capacity suffices. For example, a third party having the same capacity as the consortium member companies or entrusted/contracting companies may be entrusted with or contracted for the selected project.
- It is possible to obligate each of the consortium member companies to fund the corporation or take a subordinated loan, etc. for the period in which it is entrusted with or contracted for work.

6. Conclusion of the PFI project contract

- Provide for the deadline for concluding the PFI project contract between the administrator, etc. and the newly established corporation.

7. Failure in conclusion of the PFI project contract

- Provide that, when the conclusion of the PFI project contract fails regardless of the reason, administrator, etc. and the consortium member companies shall bear their respective costs spent for preparation of the selected project, and no credits or debts shall be incurred by any party. Specifically, the conclusion of the PFI project contract may fail in cases such as when the consortium member companies fail to coordinate the selected project among them.

Supplementary provision

The Guidelines come into effect as from July 17, 2020.