JAPAN

Law and Practice

Contributed by:
Satoru Hasumoto, Fuyuki Uchitsu, Hirohiko Tanaka and Max Yuki Tominaga
Mori Hamada & Matsumoto

Contents

Mori Hamada & Matsumoto has a construction practice that extends from traditional construction transactions to complex construction transactions involving fund structures with a special-purpose vehicle or a trust, including investment structures for overseas investors, backed by significant experience of real estate transactions. The team's work in this practice primarily includes the following: acquisition of land for construction, advising on construction-related agreements, structuring and fund formation for construction projects, and financing for construction. Recent highlights include advising an US-based data centre developer on the formation of a joint venture for hyperscale data centres, advising on hotel construction projects in Okinawa, Kyoto and Niseko, and advising on many other construction projects, including Urban Redevelopment Projects.

Authors

Satoru Hasumoto is a partner at Mori Hamada & Matsumoto and practises in the areas of construction and real estate. He advises data centre and hotel development projects for foreign investors. He has considerable international experience, having advised across multiple jurisdictions, including the USA, UK, Australia and Singapore. His publications include *"Legal Considerations Concerning Real Estate Investments in Data Centres Currently Drawing Attention"* (The Finance, October 2020), *"An Introduction to Real Estate Financing in the US"* (ARES Journal, October 2020) and *"Outline of Real Estate Investment Regarding Data Centres"* (ARES Journal, December 2019).

Fuyuki Uchitsu is a partner at Mori Hamada & Matsumoto, who practises in real estate, construction, structured finance and banking. He advises on a wide range of real estate and construction transactions, including acquisitions, developments and large-scale redevelopments. His publications include *"An Overview of the Urban Redevelopment Act: Increasing Involvement of SPCs in Urban Redevelopment Projects"* (ARES Journal, February 2023) and *"An Introduction to Commercial Construction Loans in the US"* (ARES Journal, June 2022).

Hirohiko Tanaka is a partner at Mori Hamada & Matsumoto, whose practice areas cover construction, real estate, renewable and other energy, infrastructure and banking. His publications include *"Infrastructure Investment – System, Contract and Practice of PPP/PFI/Concession"* (Nikkei BP, September 2019, co-authorship).

Contributed by: Satoru Hasumoto, Fuyuki Uchitsu, Hirohiko Tanaka and Max Yuki Tominaga,
Mori Hamada & Matsumoto

Max Yuki Tominaga is a senior associate at Mori Hamada & Matsumoto, and practises mainly in the areas of construction, real estate, project finance for infrastructure and power plant projects, PFI/PPPs, investment funds and other bespoke structured finance transactions in Japan and several Asian countries. He has broad and global experience in construction law in the areas of residential properties, hotels, logistics facilities, power plants and public facilities, among others. His publications include *"International Comparative Legal Guide to: Construction & Engineering Laws and Regulations Japan"* (2022, 2023 and 2024).

Mori Hamada & Matsumoto

Marunouchi Park Building
2-6-1 Marunouchi
Chiyoda-ku
Tokyo 100-8222
Japan

Tel: +81 3 6212 8330
Fax: +81 3 6212 8230
Email: info@morihamada.com
Web: www.morihamada.com

Contributed by: Satoru Hasumoto, Fuyuki Uchitsu, Hirohiko Tanaka and Max Yuki Tominaga,
Mori Hamada & Matsumoto

1. General

1.1 Governing Law

The principal statutes governing the construction market in Japan include the following:

- the Civil Code, which provides general rules applicable to contracts and torts;
- the Building Standards Act, which provides minimum standards concerning the site, construction, equipment and use of buildings;
- the Construction Business Act, which provides the rules applicable to (sub)contractors, including the necessary licence, regulations, statutory requirements for construction agreements, roles of the main contractors and subcontractors, and alternative dispute resolution (ADR);
- the Act on Architects and Building Engineers, which provides the rules applicable to architects, including the necessary licence, regulations and statutory requirements for design contracts; and
- the Real Estate Brokerage Act, which mainly provides real estate brokerage business but also includes some restrictions on sales and other actions before the completion of construction work.

Also, residence-related laws such as the Housing Quality Assurance Act apply to residential buildings. Furthermore, contractors must comply with acts requiring buildings to be handicapped-accessible, environmentally friendly and earthquake-resistant.

1.2 Standard Contracts

There are some standard forms with respect to construction and design in Japan. The features of each form are as follows.

- The *"General Conditions of Construction Contract"* (*minkan (nanakai) rengoukyoutei kouji ukeoi keiyaku yakkan*) published by the General Conditions of Construction Contract Committee (which is a group of seven associations and organisations) (Seven Associations GCCC) in Japanese is the form of construction-only contract most commonly used by private employers and contractors.
- The *"General Conditions of Design and Supervisory Services Contract"* (*yonkai rengou kyoutei kenchiku sekkei kannritou gyoumuitaku keiyaku yakkan*) issued by the Research Society for General Conditions of Design and Supervisory Services Contract (which is an industry organisation consisting of four associations and organisations) (Four Associations GCDS) is the form of design and supervisory services-only contract most commonly used by private employers, designers and supervisors.
- The *"General Conditions of Design/Build Contract"* issued by the Japan Federation of Construction Contractors is the form of design-and-build contract. In Japan, design and construction are often ordered from employers to contractors and designers separately, in which case the Seven Associations GCCC and the Four Associations GCDS are typically used. However, in the case of a design and build contract (both are ordered from the employers to one party acting as a designer and a contractor at the same time), this form can be adopted.
- For the construction of some domestic power plants, the *"Model Form for Domestic Plant Construction Work"* issued by the Engineering Advancement Association of Japan is used. However, a customised engineering, procurement and construction contract is often adopted for renewable energy projects.

- The *"General Conditions of Public Construction Standard Contract"* (*koukyou kouji hyoujyun ukeoi keiyaku yakkan*) is typically used as a standard form for projects involving public works. Aside from government agencies and local governments, private electric power companies, railway companies and other companies that regularly order construction work also use this form.
- Recently, in some cases where offshore parties are involved in the construction project (such as offshore wind farm projects), FIDIC-based contracts may be adopted when agreed between the parties.

2. Parties

2.1 The Employer

In Japan, employers can range from very large to small legal entities, including SPCs for joint venture and real estate investment, individuals and governmental bodies. In some cases, such as housing construction, there can be multiple employers, and they jointly and severally owe obligations, including the payment of the contract fee.

General Rights and Obligations of the Employer

The rights and obligations of the employers vary, depending on the contracts, including contract templates such as the Seven Associations GCCC among private entities, the General Conditions of Public Construction Standard Contract ordered by governmental bodies, or tailor-made construction contracts negotiated for project finance. Despite the differences among contracts, common and typical rights and obligations of the employers include:

- the right to supervise the work and inspect the completed work by itself or an appointed third party;
- the right to request repair of defects, deliver substitutes, reduce the payment amount, or compensate for loss or damage (please see **3.11 Defects and Defects Liability Period**);
- the right to request additional work or a change of the work scope and timeline in exchange for an increase or decrease of the contract fee proposed by the contractor;
- the right to cease or suspend the construction work before completion by compensating for loss or damage incurred by the contractor;
- the obligation to pay the construction fee;
- the obligation to secure the land for construction work; and
- the obligation to compensate the contractor when the employer orders the construction work to cease or be suspended.

General Relationship Between the Employer and the Contractor

Employers and contractors have contractual relationships under construction agreements. These days, due to the active market and high demand for construction, contractors tend to have strong bargaining power, and, in some cases, contractors do not accept any changes requested by employers from the Seven Associations GCCC or their own contract template.

General Relationship Between the Employer and the Subcontractors

Typically, in Japan, the employer orders all construction work to one contractor in a lump sum, and the contractor then contracts with several subcontractors. In this case, employers and subcontractors do not have any direct contractual relationships; rather, contractors have direct contractual relationships with subcontractors and owe an obligation to employers to super-

vise subcontractors. On the other hand, if, for example, the employer is able to manage and co-ordinate the work of several contractors, the employer may elect to directly execute an agreement with the subcontractors (eg, equipment contractors) separately from the construction of the main building itself.

General Relationship Between the Employer and the Financiers

In order to monitor the progress of the construction, financiers request employers to submit periodical construction reports to financiers and may ask for further rights such as a separate inspection by the lenders. For project finance, because it is important for the construction of building or facilities to be properly completed, financiers tend to be actively involved in the monitoring of the construction and advocate for strong rights against the employers.

2.2 The Contractor

In Japan, contractors are required to obtain a construction licence. Under the Construction Business Act, contractors are required to obtain a permit from the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) (if the construction business is conducted in two or more prefectures) or the prefectural governor (if the construction business is conducted in one prefecture only) if a certain threshold is met. This threshold includes conducting construction work for a fee of at least JPY5 million or, for large-scale and complicated construction, JPY15 million.

Usually, the contractor is a single company, though for large-scale and technically challenging works joint ventures may be formed by several companies.

General Rights and Obligations of the Contractor

The rights and obligations of the contractors depend on the contracts agreed upon, though the common and typical rights and obligations of contractors include:

- the right to receive construction fees from the employer, including additional fees if the contractor conducts additional work;
- the right to request compensation when the employer directs it to cease or suspend construction work;
- the right to cease construction work or terminate the contract if the employer breaches certain obligations and fails to remedy the breach despite written notice from the contractor;
- the obligation to perform the agreed construction work in accordance with contractual and applicable legal requirements, within the stipulated timeline;
- the obligation to repair defects or deliver substitutes when there are any defects in the completed work;
- the obligation to purchase and maintain certain insurance for construction required under the contract;
- the obligation to compensate third parties if the construction work causes any damage to them; and
- the obligation to support the required inspection under contracts and applicable laws.

General Relationship Between the Contractors and the Subcontractors

Contractors often subcontract part of the construction work to one or more subcontractors. Thus, contractors and subcontractors have contractual relationships. Contractors, as employers under the subcontract agreements, manage and pay subcontract fees to subcontractors, and

subcontractors, as contractors under the subcontract agreements, provide agreed construction work and receive a fee. Typically, in Japan, contractors are large-scale companies (some are called *"super general contractors"*) and have wide discretion to select subcontractors without the employers' consent. As such, contractors tend to have bargaining power compared to subcontractors, which are middle-to-small-scale companies or individuals.

General Relationship Between the Contractors and the Financiers

Ordinarily, contractors and financiers do not have any contractual relationships. However, in project finance or real estate investment projects, financiers of the employers may require that certain provisions, including limited recourse clauses from a bankability perspective, be incorporated into the construction agreement. Also, in some project finance cases where lenders hope to have direct contractual relationships with contractors, lenders request to execute a direct agreement with the contractors.

Please see **2.1 The Employer** regarding the relationships between the contractors and the employers.

2.3 The Subcontractors

Typically, in Japan, subcontractors are middle-to-small-scale companies or individuals, and in some cases they are required to specialise in a particular field and technique for the construction of specific facilities, including power generating plants and aquaculture facilities.

General Rights and Obligations of the Subcontractor

Generally, in Japan, contractors owe the obligation to employers to complete the entire construction work. The contractors order some part of the work, at their own discretion, to subcontractors selected by the contractors by executing an outsourcing agreement. Hence, subcontractors often have contractual relationships only with contractors and usually do not enter into any direct agreement with an employer. The rights and obligations of subcontractors depend on the outsourcing agreements, and contractors and subcontractors tend to have their own contract templates. The relationships and bargaining power between the two parties are decisive for which template or format will be used, but in many cases subcontractors' rights and obligations are similar to those of contractors mentioned in **2.2 The Contractor**.

General Relationship Between the Subcontractors and the Financiers

As mentioned above, contractors commonly have rights and assume all obligations with employers and financiers, and then outsource part of the work to the subcontractors. Hence, the subcontractors rarely have direct contractual relationships with financiers.

Please see **2.1 The Employer** and **2.2 The Contractor** regarding the relationships between the subcontractors, and the employers and the contractors.

2.4 The Financiers

Banks are the main players as debt financiers in Japan. Other institutional investors such as insurance companies, leasing companies or pension funds also play important roles in the market, whether in debt or in equity.

General Rights and Obligations of the Financiers

Debt providers usually have structural or contractual priority over equity providers. In the case of construction project finance, there is usually

no source of interest to be paid to the debt providers, so lenders usually seek a reserve sufficient to receive interest payments and other disbursements during the construction period. In addition, during the construction period, dividends to equity providers are generally prohibited. Debt providers in construction project finance usually require securities over all of the major assets of the borrower (ie, the employer), including land, insurance claims and other related rights and claims. For project finance, financiers usually request security over the rights and contractual status of the employers under the construction contracts. Finance providers have information rights to receive the necessary documents and information (such as financial statements).

Please see **2.1 The Employer**, **2.2 The Contractor** and **2.3 The Subcontractors** regarding the relationships between the financiers, and the employers, the contractors and the subcontractors.

2.5 The Designer

Construction companies, architectural design companies/offices and individual architects are the typical designers in Japan. Under the Act on Architects and Building Engineers, designers are required to obtain licences to conduct certain design work. For instance, those who design buildings with two or more floors and a total floor area of more than 1,000 sqm are required to be licensed as *"first-class architect"* by MLIT. There are also *"second-class architect"* and *"wooden building architect"* licences, with more restricted permitted scopes of work.

General Rights and Obligations of the Designer

The rights and obligations of the designer depend on the scope of the design agreement. The Four Associations GCDS, which is the most commonly used template for design agreements in Japan, includes supervisory work by the designer. The designers' rights and obligations in this template include:

- the right to receive design and supervisory fees from the employer, including additional fees if the designer conducts additional work;
- the right to request compensation when the employer orders the design work to cease or be suspended;
- the right to cease design work if the employer breaches certain obligations or to terminate the contract by paying compensation to the employer;
- the obligation to perform the agreed design and supervisory work under the contract and applicable laws, within the stipulated timeline; and
- the obligation to revise defects or deliver substitutes when there are defects in the completed work.

General Relationship Between the Designers, the Employer and the Contractor

Designers have a contractual relationship with the employers. Although designers, contractors and subcontractors are not always the parties to one agreement, in some cases a designer is appointed by the employer as a supervisor of the construction work. In such a case, designers, contractors and subcontractors collaborate with each other to check if the construction work is carried out and completed in accordance with the construction plan and blueprints.

3. Works

3.1 Scope

The scope of the construction work is commercially agreed upon and attached as an exhibit to the construction contract to specify the construction work. The exhibit includes the specifications, requirements, design, floor plan, invoice and/or materials of the facilities to be constructed. The exhibits can be so voluminous that they are often stored in separate physical files and electronic data.

3.2 Variations

In Japan, employers may order variations of work when necessary and contractors may request a necessary variation of work if there is a reasonable ground for such request. In either case, the contractor may propose the scope and method for the change in the work as well as the amount of the increase or decrease in the construction fees. Once the employer agrees to the proposal, the scope of work and the construction price will be amended.

To the extent agreed, the timeline for the construction work can be revised concurrently, and such change of schedule may be grounds for an increase of remuneration for the construction.

If an employer orders a variation and the contractor incurs a loss or damage, the employer is required to compensate the contractor for such loss or damage.

3.3 Design

The scope of work and responsibilities of the designers are often agreed upon in the design agreement, typically in the Four Associations GCDS template, which is separate from the construction contract. Therefore, the responsibility for the design process is taken by the designer, not the contractors. Generally speaking, employers are not responsible for the design work unless the employers:

- specifically direct and cause the designers to act wrongfully; or
- engage in any activities that are contrary to the purpose of the design agreements.

3.4 Construction

Unless employers specifically direct and cause the contractors to act wrongfully or engage in any activities that are contrary to the purpose of the construction contract, contractors are fully responsible to the employers for the construction work, in principle, even if the cause of a defect or breach lies with the subcontractors.

Between contractors and subcontractors, subcontractors are liable for the results within the scope of the outsourced work.

A designer can be liable to the employer for overlooking construction defects if the scope of their work includes supervising the construction work.

3.5 Site

Employers must ensure that the construction site can be used by the date necessary for the work. As such, employers are, in principle, liable for the risks to the condition of the construction site. However, this risk allocation is not governed by any mandatory or regulatory law, so parties may contractually agree upon a different risk allocation.

3.6 Permits

Requirements for the Buildings

In Japan, the Building Standards Act stipulates minimum standards for the site, construction, equipment and use of buildings. Contractors

and designers are responsible for the construction and design complying with the requirements under the act.

Although this act stipulates various complicated and technical requirements, the basic points are that:

- the employer (in reality, designers act for the employer) must apply for confirmation that the designed building complies with all building regulations and must receive a compliance certificate from an authorised person/entity (such confirmation being *"Construction Confirmation"*) and
- after the completion of the building, the employer (in reality, contractors act for the employer) must apply for inspection by an authorised person/entity to determine whether the completed building complies with all building regulations and must receive a compliance certificate from an authorised person/entity.

Technically, the employer applies for such confirmation and inspection, though designers and contractors prepare the necessary documents and take responsibility for the result. If any issues are found in the procedure, designers and contractors are responsible for those issues and are thus obligated to repair and revise the defect in order to pass the inspection.

Sales of the Buildings

If a seller of a (unit of a) building is *"Real Estate Broker"* under the Real Estate Brokerage Act (ie, an individual or entity engaged in a business in which they buy, sell or exchange building lots or buildings, or provide intermediary or agency services therefor with the required permit), the seller must comply with certain regulations in addition to the general requirements under the act. Such special requirements include:

- not signing a contract with a buyer before obtaining the Construction Confirmation;
- not advertising before obtaining the Construction Confirmation;
- the seller being required to explain to buyers the required additional information pursuant to the act; and
- not receiving deposits exceeding a certain threshold unless an indemnity agreement with a bank or other financial institution has been executed to protect the buyer.

3.7 Maintenance

Before the handover of the completed work, contractors are responsible for the maintenance of the works. Contractors basically assume all obligations and risks of the construction work during that period, and maintenance of the works is a part of those obligations.

Once the completed work is delivered to an employer in accordance with the construction contract, the responsibility of the maintenance shall also be transferred to the employer as a property holder, with discretion on the method of the maintenance. In some cases, employers entrust the contractors or their affiliates specialised in maintaining the same type of facilities to maintain the property, by executing a separate property management agreement or maintenance agreement, considering that contractors already know the specifications and appropriate maintenance method.

3.8 Other Functions

It is possible for an employer to instruct the contractor on other functions, though this is not always the case; typically, contractors have discretion on every function, besides what is spe-

cifically ordered by the employer in the relevant case.

3.9 Tests

Before the full handover of the completed work, contractors are typically obligated to:

- conduct contractually agreed tests; and
- provide support to pass statutory inspections.

The purpose of the contractually agreed tests is to confirm that the completed work satisfies all requirements under the construction contract, which may include the specifications of the facility. It is often the case, especially in the case of complex facilities such as power plants and data centres, that the methods and passing criteria of such tests are agreed in advance when the contracts are executed.

Statutory inspections include an inspection by an authorised person/entity under the Building Standards Act to confirm whether the completed building complies with all building regulations. Please see **3.6 Permits**.

If any other tests are required under the design and supervisory agreements, contractors are required to co-operate when these tests are conducted.

In any case, employers and their appointees have the right to be present when the tests are conducted.

3.10 Completion, Takeover and Delivery

The processes of completion, takeover and delivery are agreed upon in the construction contract. Generally speaking, when the contractor determines that the construction work is ready for completion tests, they ask the employer to conduct the required tests and inspections, including statutory ones. If the facility passes the tests and no physical, performance and regulatory defects are found, the contractor will deliver the facility to the employer.

If the facility fails the tests or issues are found in the inspection, the contractor must repair the facility or resolve the issues until the facility passes the tests and all issues are resolved.

The employer and contractor may agree to:

- the use by the employer of part of the facility; and
- partial delivery to the employer before the tests and inspections are completed, other than those required under mandatory regulations.

Such agreements are useful when full turnover takes time and partial use and delivery generate profits for the employer.

3.11 Defects and Defects Liability Period

Defect Liability Period

Under the Japanese Civil Code, the claim period for non-conformity to the contract is ten years from delivery or five years from knowledge that they can exercise their rights of the claim, whichever is earlier.

That said, market practice (under the Seven Associations GCCC) has modified the general rule as follows:

- a) contractors are liable for non-conformity to the contract (which includes defects found in a building) for two years from delivery;
- b) notwithstanding a) above, contractors are not liable for any non-conformity in the main parts of building equipment, interior finishings or decorations, furniture, trees or plants

or other similar items, unless the employers require the contractor to cure such non-conformity immediately after inspection at the time of delivery of the construction work – provided, however, that if such non-conformity could not be discovered by the employers with due care during the inspection the employers may make a claim within one year after the date of delivery;

- c) employers are required to make a claim for non-conformity under a) and b) above in a manner clearly expressing the intention to pursue the claim against the contractor for liability due to non-conformity, with the grounds for the claim and calculation of the amount claimed as damages;
- d) if the employer discovers the non-conformity within the claim period described in a) or b) (the *"Non-Conformity Liability Period"*), notifies the contractor of the non-conformity within the Non-Conformity Liability Period, and makes a claim in the manner described in c) within one year from the notification of non-conformity, such claim will be deemed to have been made within the Non-Conformity Liability Period;
- e) notwithstanding a) to d) above, the limitation under a) to d) above does not apply if the non-conformity was due to the wilful act or gross negligence of the contractor – in this case, the general rules under the Civil Code shall apply; and
- f) lastly, with respect to a construction contract for a new house prescribed in the Housing Quality Assurance Act, the defect liability period cannot be shorter than ten years after the date of delivery – this statutory requirement is applicable to defects in certain main structural and rainwater-proof components.

If the above periods have lapsed, the employer's right to seek remedies described below will be forfeited.

Remedies Available to the Employers

If defects are found in the construction, the employer may demand the repair of the defect, delivery of a substitute, reduction of payment, or compensation for loss or damage. These remedies are available whether the demand is made before or after the handover to the employer – provided that the demand was made within the explained defect liability period and the employer completed the described requirements and procedures.

4. Price

4.1 Contract Price

In Japan, a lump sum fixed contract price is widely adopted in the market, and a change in price is subject to the terms and conditions stipulated in the contract (please see **3.2 Variations**) or the parties' mutual agreement.

Under the Seven Associations GCCC, immediately after the signing of the construction contract, the contractor is required to submit the breakdown of the contract price to the employer and its appointed supervisors for their review.

Milestone payments are often agreed between the employer and contractor. Typically, such payments are made:

- upon the commencement of the work;
- upon reaching one or more interim milestones (eg, at the time of framework raising); and
- upon the completion of the work.

While it depends on the agreement, the last payment is typically the largest payment.

4.2 Indexation

Possible grounds to change the construction fees include unexpected changes in laws, inflation and wage increase. These are stipulated in the Seven Associations GCCC.

Though indexation provisions have rarely been used in Japan, due to the current economic status and possible future inflation, some contractors may ask to include clauses for more flexibility to change the contract price. In addition, the amended Construction Business Act, which took effect at the end of 2024, provides a legal framework for construction contract price adjustments. Under the amendment:

- provisions to change the contract price or calculate a new price on the grounds of inflation must be stipulated in construction agreements;
- before entering into construction agreements, contractors are obligated to notify employers of the risk of contract price increases due to possible difficulties in procurement or price increases affecting major construction materials, and in certain types of construction, lack of labour due to force majeure circumstances; and
- private employers are obligated to make an effort (and public employers are obligated) to discuss with the contractor if the contractor makes a reasonable request for a contract price increase pursuant to the construction agreement – MLIT is entitled to inspect whether such discussions are properly made and to publish the results of the inspection.

These amendments were made with a view to (among others) preventing the rising materials prices from putting pressure on wages, and allowing contractors to pay higher wages to their workforce.

4.3 Payment

Milestone payment is the prevailing method for payment (please see **4.1 Contract Price**). If contractors are concerned about late or non-payment, they can request a larger ratio of the price to be paid at the commencement of the work or middle milestones.

Also, a default charge clause (typically, 10% or 14.6% per year) is a measure for deterring late or non-payment.

4.4 Invoicing

In Japan, a lump sum fixed fee is widely adopted and changes to the payment amount are not unpredictable (please see **4.1 Contract Price**). For this reason, periodical invoicing is not necessary in practice.

Typically, a fee estimate issued before signing the construction contract and for variations can be the basis of a final invoice, indicating the final amount of the contract price.

5. Time

5.1 Planning and Programme

In Japan, contractors prepare an outline construction schedule, including the necessary work and time for temporary works, permanent works, tests and inspection, and estimated delivery date. These will be discussed between the employer and the contractor, and the Seven Associations GCCC requires contractors to submit the finalised construction schedule to the employer immediately after the signing of the construction contract.

5.2 Delays

It is often the case that the contractor periodically reports on the progress of the construction to the employer and, as a result, both parties can recognise possible delays before the deadlines. When the construction work is likely to be delayed, parties first discuss the necessary steps to accelerate the work and/or an extension of the timeline. Depending on the reasons for the delay, parties may agree to increase the contract fee or compensate for the delay. It is relatively rare to terminate the contract based on non-material delays as it is detrimental to both parties to cease and abandon the construction or to look for new contractors, which are likely to cost more than maintaining the original contractor.

Reflecting this practice, an extension of time is widely accepted in construction contracts. For instance, employers may propose an extension when it is necessary without any rationale under the Seven Associations GCCC. Please see **5.4 Extension of Time** for the grounds of extension requested by contractors.

If the construction work delays due to the contractor's breach, remedies are available to the employer. Please see **5.3 Remedies in the Event of Delays**.

5.3 Remedies in the Event of Delays

In the event that construction work is delayed after the agreed deadline, the employer may terminate the construction contract or claim compensation and default charges against the contractor for loss or damage incurred. Due to the inefficiency of terminating the contract, employers tend to choose to seek compensation. Under the Seven Associations GCCC, a penalty for delay in delivery of 10% per annum on the contract price is stipulated as liquidated damages. In project finance, the amount of liquidated damages tends to be negotiated to cover the estimated cash flow.

5.4 Extension of Time

The grounds for time extension are stipulated in construction contracts. For example, under the Seven Associations GCCC, contractors may request a time extension in cases where:

- there is ambiguity or a discrepancy in the design, specifications and conditions;
- the employer requests examination by breaking and uncovering the construction to clarify any suspected non-compliance with the construction documents, but the work is found to be in compliance with such documents;
- there is damage to a third party due to the construction work, which is not attributable to the contractor;
- there is damage to the contractor due to the construction work, which is attributable to the employer;
- an issue is found in the course of a statutory inspection, which is not attributable to the contractor, and the parties agree to take necessary steps to resolve the issue;
- the contractor agrees to partial use of the facilities, as requested by the employer, before the completion of work;
- construction resumes after an employer's request to terminate the construction work, and reasons for a necessary extension are given by the contractor;
- construction resumes after any ground for the termination of the construction contract by the contractor is resolved, and reasons for a necessary extension are given by the contractor; and
- there are any other reasonable grounds, including force majeure or a request for additional work or a change in the work.

There are some patterns for determining whether or not and for what period an extension of time should be granted. One way is that contractors propose the necessary time for the extension based on the agreed grounds of the time extension, and parties will discuss and agree on the necessity and period for the time extension. As the reasons for the time extension are various and depend on the situation, there is no specific criteria other than *"necessity"*, though excessive extensions will not be awarded.

5.5 Force Majeure

In many cases, force majeure is defined as an act of God or other natural or artificial cause for which neither party is responsible or able to control. This includes natural disasters such as earthquakes, floods and typhoon, war, terrorist attacks and riots. After the COVID-19 pandemic, some contracts include infectious disease in the definition of force majeure. There is no statutory requirement for the definition of force majeure, and the parties may contractually agree upon the scope of force majeure.

Typically, when any force majeure event occurs, contractors are entitled to ask for an extension in the construction schedule and a suspension or cessation of the work, and sometimes for an additional cost/increase of the contract price depending on negotiation.

5.6 Unforeseen Circumstances

If unforeseen circumstances fall within the definition of force majeure, the same rule for force majeure is applicable. Please see **5.5 Force Majeure** for the typical consequences.

In Japan, there is also a general legal principle of *"Change of Circumstances"*, which allows either party to amend or terminate an agreement under extraordinary changes in the social environment that were impossible to expect at the time when the contract was signed, such that it is unfair to enforce the original agreement. Unexpected changes in laws or extreme inflation may be a possible example, and the Seven Associations GCCC includes the provision derived from this principle as a ground to change the contract price (please see **4.2 Indexation**).

However, it is very rare in Japan for the courts to apply this legal principle. Hence, parties should not rely on this principle and its derivatives. If any specific grounds and consequences for unforeseen circumstances are necessary, they should be clearly discussed and agreed upon by all parties.

5.7 Disruption

In Japan, disruption itself is not an individual legal concept that is widely accepted as a ground for extension of time or compensation. It may be one of the components of force majeure, and, if a certain type of disruption falls within the definition of force majeure, the same rule for force majeure is applicable. Please see **5.5 Force Majeure**.

If any specific grounds and consequences for disruption are necessary, it should be clearly discussed and agreed upon by all parties.

6. Liability

6.1 Exclusion of Liability

There are no specific mandatory law provisions in Japan that prohibit certain clauses in construction contracts or design contracts to exclude the liability of a party, other than general legal concepts.

One such general legal concept is the violation of public policy; that is, if specific terms of the contract are considered offensive to public order, such terms are unenforceable on an ad hoc basis due to the principle of public policy.

As a derivative of such a concept, under the Consumer Contract Act, if the employer is *"consumer"*, and any terms of the contract restrict the consumer's rights or expand the consumer's obligations to the extent that such terms unilaterally prejudice the interests of the consumer and violate the fundamental principle of public order, such terms are void.

6.2 Wilful Misconduct and Gross Negligence

In Japan, gross negligence is often referred to as negligence amounting to a wilful act or omission, or a significant deviation from the ordinary duty of care which a person in similar situation would owe. In legal commentary, this has been described as that a person acts with gross negligence where the person could have easily foreseen and avoided the result with ordinary duty of care but has not. The analysis of the concept of *"gross negligence"* has developed under precedents, and mandatory or regulatory laws do not provide the details of the concept.

On the other hand, there is no separate legal concept of wilful misconduct in Japan. This concept is also discussed under *"intentionally"* or *"with gross negligence"*.

6.3 Limitation of Liability

It is possible for the parties to limit their liability under construction contracts or design contracts, unless otherwise prohibited in applicable laws.

One such law is the Housing Quality Assurance Act, which prohibits limiting contractors' defect liability period to being shorter than ten years after the date of delivery in certain cases. Please see **3.11 Defects and Defects Liability Period** for when the Housing Quality Assurance Act is applicable.

7. Risk, Insurance and Securities

7.1 Indemnities

In Japan, the concept of indemnification is not common. Instead of indemnification, compensation is widely recognised as the legal concept equivalent to indemnification.

When a party breaches a contract, including non-conformity with the provisions or requirements and delay in delivery of the completed work or the payment of the construction fee, the breaching party is liable to compensate the non-breaching party for the loss or damage incurred to the extent that the breach has a causal link to such loss or damage.

In project finance, parties typically agree to incorporate the concept of liquidated damages, which is a special provision for compensation in that the amount of loss and damage are agreed to be fixed to cover the estimated cash flow when the construction schedule is delayed.

From this perspective, compensation functions to fairly allocate the risks of damages to the parties.

7.2 Guarantees

In Japan, generally speaking, it is not common to require a guarantee from private parties, especially when an employer is a company in sound financial condition.

On the other hand, in some public works, the government may require the contractor to provide a guarantee for the performance of certain construction work or other obligations. The terms and conditions of the performance bonds are determined by the government office in charge of the project, and it is usually difficult to negotiate for any change. Such performance bonds are typically in the form of a demand guarantee under the Uniform Rules for Demand Guarantees published by the International Chamber of Commerce.

7.3 Insurance

Companies, including employers and contractors, are required by statute to obtain labour insurance and social insurance for their employees.

No statutory insurance is specifically required for contractors to carry out construction work or design and supervisory services.

Contractors usually purchase and maintain fire insurance or contractors' all risk insurance for the executed portion of the construction work, materials and/or building equipment delivered to the construction site. Considering that, recently, construction works have become larger and more complicated, under the Seven Associations GCCC, contractors are required to purchase fire insurance, contractors' all risk insurance or other agreed insurance.

Also, contractors purchase guarantee insurance for liability for non-conformity and non-performance of obligations when they construct new residences, to address the requirement under the Act on the Assurance of Performance of Specified Housing Defect Warranty.

Regarding design and supervisory services contracts, if the designers and supervisors are from an architectural firm, the founders of the architectural firm have a duty to make efforts to purchase and maintain business insurance that covers losses in connection with their design and supervisory services.

7.4 Insolvency

Contractual Provisions

There are a few provisions related to insolvency under the Seven Associations GCCC and the Four Associations GCDS. However, parties can separately agree to include insolvency-related provisions and limited recourse clauses, including prohibiting contractors from filing for bankruptcy for a certain period.

Statutory Rules

The Civil Code contains a special rule when the employer is insolvent. During the insolvency procedure, the employer's bankruptcy trustee (or, in the case of civil rehabilitation, the employer with the court's permission) and the contractor may terminate the construction contract, if the work is not completed.

On the other hand, the Bankruptcy Act or the Civil Rehabilitation Act applies when the contractor is insolvent and the work can be completed by another contractor. During the contractor's insolvency procedure, the contractor's bankruptcy trustee (in the case of civil rehabilitation, the contractor with the court's permission) has an option to terminate the construction contract or request the employer to perform its obligation, including payment of construction fees.

In both cases, contractors are entitled to receive construction fees in proportion to the progress of the work. However, in the case of employers' bankruptcy, such remuneration will be paid in

the insolvency procedure to the extent that there are enough funds to distribute.

7.5 Risk Sharing

In general, risk allocation is an issue to be agreed between the parties.

In the context of typical construction contracts:

- before the delivery of the completed facility, the contractor bears all risks other than loss or damage incurred that are attributable to the employer; and
- upon delivery, such risks transfer to the employer.

That said, in cases of force majeure, some contractors' obligations before the delivery can be deferred or released. Please see **5.5 Force Majeure**.

8. Contract Administration and Claims

8.1 Personnel

Under the Construction Business Act, contractors are obliged to engage a chief engineer, and, in certain cases, a managing engineer, an assistant managing engineer and/or a specialised engineer. They must satisfy the requirements stipulated in the act – mainly to have certain licences and experience. Also, contractors may engage an on-site agent. Owing to the governmental policy on work-style reform, the regulations on the appointment of full-time chief engineers and managing engineers were eased under certain conditions, including the utilisation of ICT, pursuant to the amended Construction Business Act, which took effect at the end of 2024.

Reflecting these statutory requirements and provisions, the Seven Associations GCCC includes a provision requiring the contractor to engage the necessary personnel and to notify the employer of the names of such personnel.

Under the Seven Associations GCCC, one person may be a chief engineer, managing engineer or assistant managing engineer, specialised engineer and on-site agent at the same construction site concurrently.

8.2 Subcontracting

In principle, subcontracting all of the construction work is prohibited under the Construction Business Act. However, for constructions of any type other than new apartment buildings, the Construction Business Act allows subcontracting all of the construction work with prior written consent from the employer. Also, there is no statutory limitation on subcontracting part of the construction work.

This is also reflected in construction contracts, including the Seven Associations GCCC – that is, the contracts prohibit subcontracting all of the construction work without obtaining the prior written consent of the employer for constructing facilities other than a new apartment building, in which case subcontracting all of the construction work is prohibited in any case.

8.3 Intellectual Property

The Seven Associations GCCC provides that the contractor shall be solely responsible for using any materials, building equipment or construction methods that contain any protected third-party intellectual property (IP), except if all the following requirements are met:

- the employer designated the materials, building equipment or construction method;

- the design documents do not clearly state that they contain third-party IP; and
- the contractor is not aware of such third-party IP.

In the Four Associations GCDS, the general rule for IP is that any IP attached to the completed building based on the design prepared by the designer belongs to such designer, and the employer may use such IP.

9. Remedies and Damages

9.1 Remedies

Employer

In the case of any breach, including non-conformity, under construction contracts or design contracts, the employer is typically entitled to require the contractor or designer to:

- repair the defect or deliver a substitute;
- reduce the payment amount;
- compensate for loss or damages; or
- terminate the contract.

These remedies are not mutually exclusive, and employers may choose any option to recover the loss or damage incurred.

Contractor and Designer

The most important claim for contractors and designers is remuneration for construction or design and supervisory work. If the employer fails to pay, the contractor or designer is entitled to claim default charges, in addition to the remuneration itself.

In addition, under the Seven Associations GCCC, a contractor may stop the construction work or terminate the construction contract if the employer fails to ensure and provide the necessary construction site or to pay the milestone payments.

As for designers, the Four Associations GCDS provides that a designer may stop the work or terminate the design contract if the employer fails to pay the design fees, or if the work is delayed due to a reason attributable to the employer.

9.2 Restricting Remedies

In Japan, it is not common practice to contractually limit the remedies available to employers and contractors. Conversely, the Seven Associations GCCC clarifies that all remedies available to employers in the case of non-conformity by the contractors under the Civil Code are also available to the extent that employers follow the procedural requirements. Please see **3.11 Defects and Defects Liability Period** for such procedural requirements.

That said, employers and contractors may agree to limit the available remedies to the extent that such limitations do not violate public order or (if the employer is a consumer) the Consumer Contract Act. Please see **6.1 Exclusion of Liability**.

As for the design contracts, compared with construction contracts, limitations on the compensation amount are more acceptable in the Japanese market.

9.3 Sole Remedy Clauses

In Japan, contractual sole remedy clauses are not used in most construction contracts. Hence, generally speaking, in addition to remedies stipulated in construction contracts, employers and contractors may make a claim under applicable laws such as tort law.

9.4 Excluded Damages

In the Japanese market, contractors are generally liable for all forms of damage unless it is attributable to or directed by the employer. The basic idea is that contractors bear every risk for completing the construction work until the delivery, which is one of the contract types stipulated in the Civil Code.

9.5 Retention and Suspension Rights

Retention Right

In Japan, the payment of the remuneration for construction is often divided into several portions, such as the payment at commencement, single or multiple middle milestones and the completion of the work. Middle milestones include the completion of the framework of the buildings, and the last payment is paid only after passing the agreed tests and statutory inspections. Typically, although it depends on the agreement between the parties, the last payment is the biggest amount.

After the last payment has been made at the same time as the delivery, it is generally not acceptable for an employer to retain any fees. Thus, if any defects are found after the delivery, the employers need to claim compensation without any retention.

Hence, employers are substantially able to retain part of the payment only before the completion of work and delivery.

As for the designers, practically, all designing fees are paid after the completion of work. As such, similar to the contractors, the employers are able to retain the payment only before the completion of work and delivery.

Suspension Right

Contractors' and designers' suspension rights are incorporated into construction contracts and design contracts, including the Seven Associations GCCC and the Four Associations GCDS.

Typical grounds for suspending construction works are:

- delay of the employer in making advances or partial payments;
- it not being possible to proceed with the construction work because the employer failed to make the construction site available for the use of the contractor;
- significant delay in the construction work due to any ground attributable to the employer; and
- it not being possible to proceed with the construction work because of force majeure.

In addition, the common grounds for suspending design works are:

- delay in making any payments due to a reason attributable to the employer; and
- delay in the work due to a reason attributable to the employer.

9.6 Termination

Termination Event

Termination events are agreed upon by parties and provided in construction contracts. The termination events in the Seven Associations GCCC include the following:

- Termination by the employer of the construction contract:
  - (a) before the work is completed – when necessary, by compensating the contractor for the loss and damage incurred;
  - (b) after the completion and delivery – if the

defects of the facility are so material that there is no option but reconstruction;
(c) the contractor loses any necessary permit to continue the construction work;
(d) it not being possible to complete the construction work; and
(e) the contractor is found to have any relationship with antisocial forces.

- Termination by the contractor of the construction contracts:
  (a) the employer's breach (excluding minor breaches) of the construction contract;
  (b) construction work has ceased for more than two months or one fourth of the scheduled construction timeline;
  (c) construction fees are reduced for more than two thirds of the original amount due to a variation request from the employer;
  (d) employers have stopped paying their debt and lack the ability to pay the construction fees;
  (e) it not being possible to complete the construction work; and
  (f) the employer is found to have any relationship with antisocial forces.

As for the design contracts, both the employers and the designers may terminate the contracts at any time without any reason, provided that, in the case of no reasonable grounds for the termination, the terminating party compensates the other party for any loss or damage incurred due to the termination, if the timing of the termination was detrimental to the other party.

Contractual Consequences of Termination

Regardless of the ground for termination of the construction or design contract, the work completed as of the time of termination will be transferred to the employer for consideration: the employer is required to pay part of the remuneration of the contractor in proportion to the progress of the work.

Parties are also entitled to compensation for loss or damage incurred due to the termination of the contract.

10. Dispute Resolution

10.1 Regular Dispute Resolution

In Japan, parties may agree to the exclusive jurisdiction of a competent district court in construction or design contracts. Typically, a court with sufficient ability and personnel, such as the Tokyo District Court, is chosen as an agreed competent court. As construction disputes tend to have complicated and technical issues, special procedures for obtaining support from experts are stipulated in the Japanese Code of Civil Procedure.

Some large-scale courts, including the Tokyo District Court, have set up judicial units that handle construction disputes intensively, and such units are able to manage such cases smoothly. Though parties are not allowed to choose a judicial unit to deal with the case, complicated construction disputes are likely to be assigned to such intensive units, if they exist. This is a good reason to choose a large-scale court as an agreed competent court in construction and design contracts.

10.2 Alternative Dispute Resolution

Two ADR institutions are typically chosen for construction dispute resolution:

- the Committee for Adjustment of Construction Work Disputes (CACWD), established at MLIT and each prefecture by the Construction Business Act; and

- the Designated Housing Dispute Resolution Body (DHDRB), set up at each Bar Association by the Housing Quality Assurance Act, which is designated by MLIT.

CACWDs are public institutions handling construction contract disputes, and DHDRBs are private institutions dealing with construction contract disputes and the sale of residences covered by a performance evaluation report issued in accordance with the Housing Quality Assurance Act. Both CACWDs and DHDRBs are expected to resolve construction-related disputes in an effective, simple and prompt manner, with the support of experts in construction.

There are three types of procedure in CACWDs:

- mediation;
- conciliation; and
- arbitration.

Resolution by mediation and conciliation can be achieved only through agreement on the result among the parties. Hence, they are not always effective. On the other hand, an arbitration award from a CACWD can be granted without any agreement on the result between the parties, provided however that the consent of the parties to commence an arbitration is required.

Owing to such nature of CACWDs, the Seven Associations GCCC designates the CACWD as the recommended body for dispute resolution in addition to a court judgment, and has prepared the format of the advance agreement on commencing arbitration in CACWDs, which excludes going to courts. However, this is not always selected as the first option for dispute resolution, and contractors tend to choose resolution in courts (or select avoiding disputes in the first place by repairing the defects to protect their reputation). One reason may be the provision under the Arbitration Act, which allows consumers to terminate such agreement on commencing arbitration, for the purpose of protecting individuals.