GAR KNOW HOW CONSTRUCTION ARBITRATION

Japan

Aoi Inoue, David MacArthur, Masahiro Yano and Tatsuhiko Makino

Anderson Mōri & Tomotsune

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Legal system

1 Is your jurisdiction primarily a common law, civil law, customary law or theocratic law jurisdiction? Are the laws substantially derived from the laws of another jurisdiction and, if so, which? What instruments have legal force and effect? Who are the lawmaking bodies? How and where are new laws published? Can laws be passed with retrospective effect?

Japan is a civil law jurisdiction. Its laws have been historically influenced by other civil law jurisdictions such as Germany and France. The legal instruments that have legal force and effect in Japan are laws enacted by the National Diet (Japan's bicameral legislature), as well as other measures such as cabinet orders or regulations established by relevant bodies under powers conferred on them by laws enacted by the Diet. Although the executive branch has the power to issue government ordinances, those ordinances may not include penalties unless there is a law conferring such power. Courts do not have the power to "find" laws, and there is no formal principle of stare decisis (although Supreme Court decisions are adhered to in practice). Treaties become effective as law in Japan after being ratified by the Diet. New laws are published through a monthly official gazette (Kampo). With the exception of criminal laws, laws can be passed with retrospective effect, although it is generally avoided in the interests of predictability and stability in the legal framework and economy.

Contract formation

2 What are the requirements for a construction contract to be formed? When is a "letter of intent" from an employer to a contractor given contractual effect?

A contract is formed by an offer and an acceptance of specified terms. There are no particular formal requirements, although courts do require that key terms (such as price, date, etc) be sufficiently certain and supported by evidence. In principle, there is no requirement of "consideration" for a contract to be formed under Japanese law. The same principles apply to construction contracts.

As long as the above conditions for the formation of a contract are satisfied, a court will construe a 'letter of intent' as a contract regardless of its title. Otherwise, it will not be considered as a binding contract. It is possible for some terms to be found binding even if the whole is not.

Choice of laws, seat, arbitrator and language

3 Are parties free to choose: (a) the governing law of their contract; (b) the law of the arbitration agreement; (c) the seat of the arbitration; (d) any arbitral rules; (e) anyone to act as arbitrator; and (f) the language of the contract and the arbitration? If not, what are the limitations on choice and what happens if the parties act contrary to them?

Yes, under Japanese law, parties' are generally free to choose the governing law of the contract and arbitration agreement as well as the arbitral seat, rules and language, and their choice or method of selecting arbitrators. If parties select a city in Japan (such as Tokyo or Osaka) as the seat of arbitration, the Arbitration Act (Act No. 138 of 2003, as amended) will mandatorily apply.

Implied terms

4 How might terms be implied into construction contracts? What terms might be implied?

Contractual terms may be implied where such implication reflects the "true intention" of the parties, which will take into account various factors such as industry practices and good faith. In particular, when the court finds the language of the contract is ambiguous, contradictory or unreasonable, the court may take into account extrinsic evidence to fill in gaps or redress the contradiction by seeking the "true intention" of the parties.

Certifiers

5 When must a certifier under a construction contract act impartially, fairly and honestly? To what extent are the parties bound by certificates (where the contract does not expressly empower a court or arbitral tribunal to open up, review and revise certificates)? Can the contractor bring proceedings directly against the certifier?

Under the Building Standard Act (Act No. 201 of 1950, as amended), an employer of a large-scale construction must retain a certified architect as administrator for the project, whose role includes issuing certificates (and to this extent should be considered as a "certifier" in Japanese-law context). Under the Act on Architects and Building Engineers (Act No. 202 of 1950, as amended), such certifier must immediately inform a contractor of any deviation of construction works from the drawings or specifications and request amendment works. If a contractor fails to respond, the certifier must inform the employer. An architect owes a statutory duty to perform these duties fairly and honestly.

These two Acts are silent on whether the parties to a construction contract are bound by the determinations of the certifier. As to the potential liability of the certifier, in cases of exceptional negligence, a contractor could bring direct tort claims against the certifier.

Competing causes of delay

6 If an employer would cause (eg, by variation) a two-week critical delay to the completion of the works (which by itself would justify an extension of time under the construction contract) but, independently, culpable delay by the contractor (eg, defective work) would cause the same delay, is the contractor entitled to an extension?

A contractor's entitlement to an extension of time in cases of concurrent delay under Japanese law will depend primarily on the interpretation of the clause that confers on a contractor the right to claim the extension.

As a general principle, a contractor can assert a defence that a delay is not attributable to it regardless of being culpable for causing delay if the employer is independently and concurrently responsible for the same delay.

Disruption

7 How does the law view "disruption" to the contractor (as distinct from delay or prolongation to the completion of the works) caused by the employer's breaches of contract and acts of prevention? What must the contractor show for a disruption claim to succeed? If an entitlement in principle can be shown (eg, that a loss has been caused by a breach of contract) must the court or arbitral tribunal do its best to quantify that loss (even if proof of the quantum is lacking or uncertain)?

A contractor can assert a claim based on disruption. In principle, it would be like any other claim under contract or tort and the prospect of success will depend on particular facts and evidence in each case.

For a contractual claim, a contractor must prove the disruption was the result of a breach of contract by the employer, as well as demonstrate loss and the causation between the disruption and the loss. In cases where quantification of the loss is difficult for a contractor to prove, the Code of Civil Procedure (Act No. 109 of 1996, amended) confers on the court's discretion to determine a "reasonable amount" as damages taking into account the parties' submissions and evidence.

Acceleration

8 How does the law view "constructive acceleration" (where the contractor incurs costs accelerating its works because an extension of time has not been granted that should have been)? What must the contractor show for such a claim to succeed? Does your answer differ if the employer acted unreasonably or in bad faith?

A contractor can assert a claim for 'constructive acceleration'. In principle, it would be like any other claim under contract or tort and the prospect of success will depend on particular facts and evidence in each case.

To succeed on a breach of contract claim, a contractor must prove the 'constructive acceleration' was the result of a breach of contract by the employer as well as demonstrate loss and the causation between the 'constructive acceleration' and the loss. In this context, unreasonableness or bad faith by the employer may help a contractor to establish that the 'constructive acceleration' was a breach of contract by an employer.

In cases where quantification of the loss is difficult for a contractor to prove, the Code of Civil Procedure (Act No. 109 of 1996, amended) confers on the court's discretion to determine a "reasonable amount" as damages taking into account the parties' submissions and evidence.

Force majeure and hardship

9 What events of force majeure give rise to relief? Must they be unforeseeable and to whom? How far does the express or implied allocation of risk under the contract affect whether an event qualifies? Must the event have a permanent effect? Is impossibility in performing required or does a degree of difficulty suffice? Is relief available where only some obligations (eg, to make a single payment or carry out one aspect of the works) are affected or is a greater impact required? What relief is available and does it apply automatically? Can the rules be excluded by agreement?

The concept of force majeure is recognised in the Civil Code (Act No. 89 of 1896, as amended) as a defence to a claim for damages where an event not attributable to the obligor has prevented

performance of contractual obligations (other than payment of money). However, as there are very few cases in which the Japanese courts have upheld a force majeure defence, it is difficult to determine the parameters or requirements for whether a certain event constitutes a force majeure event. Rather, force majeure as a ground for release from contractual liability is usually subsumed in the termination of contract due to impossibility (article 542(1)(i) of the Civil Code) or of "no fault" (article 415 of the Civil Code) (ie, that the breach of contract was not attributable to the party who is alleged to be liable for damages).

It is not clear under Japanese law whether parties can contract out of the application of the force majeure principle in the Code as it is considered a core legal principle (although not much used in practice). It should also be noted that, while force majeure is a defence to liability, it is not a ground to terminate a contract. However, the impossibility of performance (for a reason that is not the fault of the terminating party) is a statutory ground for termination.

10 When is a contractor entitled to relief against a construction contract becoming unduly expensive or otherwise hard to perform and what relief is available? Can the rules be excluded by agreement?

As a derivative of the principle of good faith under the Civil Code (Act No. 89 of 1896, as amended), the legal doctrine of 'change in circumstances' is potentially available as a defence to liability for non-performance in cases where there has been a fundamental change to circumstances from the time of entry of contract that strongly affects the fairness of the contract terms. This principle requires (i) a fundamental change was not foreseeable at the entry of the contract, (ii) the cause of which is not attributable to the parties, and (iii) that holding the parties to the original contractual terms would be harsh and against the principle of good faith.

It is unlikely that this doctrine could be excluded, as it derives from the principle of good faith, which is considered fundamental and mandatory. However, this doctrine is rarely applied and is considered to be highly dependent on the particular facts of individual cases. It could be possible to practically limit the application of the principle by explicitly allocating risks by contract, and thereby limiting the matters that were non-foreseeable.

Impossibility

11 When is a contractor entitled to relief if after the contract is concluded it transpires (but not due to external events) that it is impossible for the contractor to achieve a particular aspect of the contractual specification? What relief is available?

Under the Civil Code (Act No. 89 of 1896, as amended), if performance of a contractual obligation becomes impossible due to any reason attributable to an employer, a contractor can be excused for such non-performance and can demand a full payment of the contract price less costs saved due to non-performance of such contractual obligations.

Clauses that seek to pass risks to the contractor for matters it cannot foresee or control

12 How effective are contractual provisions that seek to pass risks to the contractor for matters it cannot foresee or control, for example, making the contractor liable for: (a) a specified event of force majeure; (b) ground conditions that no reasonably diligent contractor could have foreseen; or (c) errors in documents provided by the employer, such as employer's requirements in design and build forms?

In general, risk allocation by contract is effective with the exception of cases where it is considered an 'abuse of right' or contrary to public policy or good faith. This general principle applies for the circumstances set out in (a) through (c) above.

Duty to warn

13 When must the contractor warn the employer of an error in a design provided by the employer?

A contractor does not have legal obligations to warn an employer of a design error unless otherwise agreed in a construction contract. However, it should be borne in mind that if a contractor does not inform an employer of a design error in spite of the contractor's awareness of such error, a contractor cannot rely on the statutory defence under the Civil Code (Act No. 89 of 1896, as amended) to its own potential liability vis-à-vis an employer that the failure to fulfil the quality standard in a contract stems from the instruction of an employer.

Good faith

14 Is there a general duty of good faith? If so, how does it impact upon the following (where they are otherwise permitted under the construction contract): (a) the level of intervention in the works that is allowed by the employer; (b) a party's discretion whether to terminate or suspend the contract; or (c) the employer's discretion to claim pre-agreed sums under the contract, such as liquidated damages for delay?

Yes, Japanese law recognises a general duty of good faith under the Civil Code (Act No. 89 of 1896, as amended). While the good faith principle can be theoretically applicable to all categories raised in the question, it is quite uncertain how and whether the courts would admit the application for individual cases as the courts will determine its application depending significantly on particular facts.

Time bars

15 How do contractual provisions that bar claims if they are not validly notified within a certain period operate (including limitation or prescription laws that cannot be contracted out of, interpretation rules, any good faith principles and laws on unfair contract terms)? What is the scope for bringing claims outside the written terms of the contract under provisions such as sub-clause 20.1 of the FIDIC Red Book 1999 ("otherwise in connection with the contract")? Is there any difference in approach to claims based on matters that the employer caused and matters it did not, such as weather or ground conditions? Is there any difference in approach to claims for (a) extensions of time and relief from liquidated damages for delay and (b) monetary sums?

Contractual provisions that bar claims that were not notified to the counterparty within the specified period are effective. However, the court might interpret such provisions narrowly where public policy or the circumstances warrant it, such as in a consumer protection context. In such case, the effect of such provisions might be limited to the extent where an obligor can claim damages incurred for the failure to give due notice but cannot enjoy the waiver of the entire claim as stipulated in the contract.

Whether the contractual notification provisions are applicable to claims from outside of the contract depends on the interpretation of the said provisions and the importance of the nature of the relevant claims.

Suspension

16 What rights does the employer have to suspend paying the contractor or performing other duties under the contract due to the contractor's (non-)performance, or the contractor have to suspend carrying out the works (or part of the works) due to the employer's (non-) performance?

Under the Civil Code (Act No. 89 of 1896, as amended), the employer's obligation to pay a contract price is linked with the contractor's obligation to deliver the completed works. Therefore, unless otherwise agreed in a construction contract, an employer can suspend the payment until a contractor delivers the completed works. On the contrary, a contractor cannot suspend its obligation to complete the works even if an employer fails to make a payment because what a contractor is entitled to is to suspend the delivery of the works after completion until an employer performs its duty to pay simultaneously. However, courts have found that a contractor is allowed to suspend construction works if the suspension is reasonable based upon the particular facts of the case.

Omissions and termination for convenience

17 May the employer exercise an express power to omit work, or terminate the contract at will or for convenience, so as to give work to another contractor or to carry out the work itself?

Unless agreed otherwise by parties in a contract, an employer can terminate a contract at will or for convenience under the Civil Code (Act No. 89 of 1896, as amended) if the employer compensates any damage incurred by the contractor.

The Civil Code is silent on the issue of omission of work by an employer. However, if a contract has no express provisions that allow an employer to omit the part of work, it is likely that a Japanese court would hold that the contractor is entitled to claim damages including lost profits on the ground that such omission of work constitutes a breach of contract by the employer.

Termination

18 What termination rights exist? Can a construction contract be terminated in part? What are the practical and financial consequences?

Apart from termination rights provided in the contract itself, the Civil Code (Act No. 89 of 1896, as amended; the Code) provides certain statutory rights of termination. Such termination rights include (without limitation) (i) where a material breach has not been cured within a reasonable period after notice, (ii) where it is impossible to perform the contract, or (iii) where the other party repudiates the contract by indicating its intention not to perform its obligations. All such termination rights require that the terminating party is not at fault for the cause of termination.

The Code allows a construction contract to be terminated in part if an employer enjoys benefits from the parts that have been completed by a contractor and that are separable from non-complete parts. If a construction contract is terminated in part, a contractor is entitled to claim that portion of the contract price proportional or attributable to the completed works. The exception is that if an employer is liable for having a contractor impossible to complete construction an employer must pay all contract price to a contractor.

19 If the construction contract provides for the circumstances in which each party may terminate the contract but does not expressly or impliedly state that those rights are exhaustive, are other rights to terminate available? If so, what are they and what are the practical and financial consequences?

A party can rely on statutory termination rights under the Civil Code (Act No. 89 of 1896, as amended), unless the construction contract excludes such statutory termination rights.

20 What limits apply to exercising termination rights?

The exercise of both statutory and contractual termination rights would be restricted if the exercise of rights would be in conflict with the principle of good faith or constitute an abuse of rights, based on the specific facts of individual cases.

Completion

21 Does the law of your jurisdiction deem the works to be completed (irrespective of what the contract says) if, say, the employer takes beneficial possession of the works and starts using them?

Under the Civil Code (Act No. 89 of 1896, as amended), if a construction contract is terminated prior to the completion of the works or if the completion of the works becomes impossible, due to the causes attributable to an employer, the finished works are deemed to be completed, and the employer liable to compensate the contractor, to the extent that the employer enjoys the benefit of said works that is separable from unfinished works.

With regard to the completion of the whole works, the Code is silent. Under the case laws, the courts determine the completion of the construction works taking into consideration whether the process of construction works is finished in spite of the need to rectify defects or discrepancy from the contractual standard. In practice, the fact that an employer takes beneficial possession of the works can be used as evidence implying the completion of the works.

22 Does approval or acceptance of work by or on behalf of the employer bar a subsequent complaint? What constitutes acceptance? Does taking over the work by the employer constitute acceptance? Does this bar subsequent complaint?

Under the Civil Code (Act No. 89 of 1896, as amended), irrespective of the acceptance of or taking over the works, an employer can claim its rights against a contractor for the breach of contract. Therefore, in general, the acceptance of or taking over the works does not constitute a waiver of employer's rights or claims with respect to such works.

Liquidated damages and similar pre-agreed sums ('liquidated damages')

23 To what extent are liquidated damages for delay to the completion of the works treated as an exhaustive remedy for all of the employer's losses due to (a) delay to the completion of the works by the contractual completion date; and (b) delays prior to the contractual completion date (in the absence of, say, interim milestone dates with liquidated damages for delay attaching to them)? What difference does it make if any critical delay is caused by the contractor's fraud, wilful misconduct, recklessness or gross negligence? If so, what constitutes such behaviour and can it be excluded by agreement?

Under the Civil Code (Act No. 89 of 1896, as amended), provisions for liquidated damages – regardless of whether arising prior to or after the completion of the works – are generally interpreted as an exclusive remedy for damages, unless the parties explicitly agree otherwise (eg, by agreeing that actual damages could be claimed in addition to liquidated damages). However, liquidated damages provisions do not preclude parties from terminating the contract or claiming for specific performance.

It is uncertain whether the fact that a critical delay was caused by a contractor's fraud, wilful misconduct, recklessness or gross negligence would affect these arguments due to the lack of case precedents.

24 If the employer causes critical delay to the completion of the works and the construction contract does not provide for an extension of time to the contractual completion date (there being no "sweep up" provision such as that in sub-clause 8.4(c) of the FIDIC Silver Book 1999) is the employer still entitled to liquidated damages due to the late completion of works provided for under the contract?

In general, Japanese law requires the party to be "at fault" for it to be labile for breach. This applies even if liquidated damages have been agreed, unless it is clear that the parties have excluded the requirement of fault. Hence the contractor would not be liable for any liquidated damages if the employer causes a critical delay to the completion of works, even if there is no extension of time provision provided for under the contract.

Under such circumstances, the contractor would likely be excused from liability for delays that are not attributable to the contractor.

25 When might a court or arbitral tribunal award less than the liquidated damages specified in the contract for delay or other matters (eg, substandard work)? What factors are taken into account?

Generally, a court or tribunal would uphold the amount of liquidated damages agreed by the parties in a contract. In exceptional circumstances, where the agreed amount of liquidated damage is contrary

to the principle of good faith or against public policy, the courts can award less than the amount of liquidated damages under its discretion.

26 When might a court or arbitral tribunal award more than the liquidated damages specified in the contract for delay or other matters (eg, work that does not achieve a specified standard)? What factors are taken into account?

As courts and arbitral tribunals would uphold the amount of the liquidated damages agreed by the parties in a contract, it would be very unusual for a greater amount of damages to be awarded. Depending on the specific facts of the case and wording of the liquidated damage provision, it might be possible to construe the provision narrowly so that actual damages could be assessed beyond the scope of such provision; this, however, is fact specific and cannot be generalised.

Assessing damages and limitations and exclusions of liability

27 How is monetary compensation for breach of contract assessed? For instance, if the contractor is liable for a defect in its works is the employer entitled to its lost profits? What if the lost profits are exceptionally high?

Japanese law recognises two categories of damages: ordinary damages and special damages. These categories of damages equally apply for breach of contract and tort. Ordinary damages are those that arise ordinarily and foreseeably from a breach of contract (or tortious act). Special damages relate to those arising from the unique circumstances of the case and are recoverable only if the party in breach should have foreseen such particular circumstances at the time of the breach (or tortious act).

Whether lost profits are considered as ordinary damages or special damages depends on the facts of the case. An exceptionally high amount of lost profits claimed by an employer might be rejected by the courts on the grounds of the lack of reasonable causation with the contractor's breach of contract.

28 If the contractor's work is technically non-compliant, is the contractor liable for remedying it if the rectification cost is disproportionate to the benefit of the remedy? Can the parties agree on a regime that is stricter for the contractor than under the law of your jurisdiction?

Under the Civil Code (Act No. 89 of 1896, as amended), if the nature of non-compliance is not important and the rectification costs are disproportionate to the benefit of the remedy, the contractor does not have an obligation to rectify. An employer can claim damages only. Parties are generally free to agree on the stricter terms for a contractor than the statutory default position although the courts might intervene based on public policy or the principle of good faith.

29 If there is a defects notification period (DNP) during which the contractor must or may remedy any defect in its works that appears during a certain period after their completion, if the construction contract is otherwise silent, does it affect the employer's rights to claim for any defects appearing after the DNP expires?

Under the Civil Code (Act No. 89 of 1896, as amended), an employer is entitled to claim rectification, deduction from the contract price, damages and/or termination of contract within one year from the time that an employer acknowledges non-conformance in quality or types of the works.

Whether the said statutory rights of an employer is affected by the expiry of a DNP clause in the contract depends on the interpretation of the relevant contract provisions.

30 What is the effect of a construction contract excluding liability for "indirect or consequential loss"?

Although the phrase "indirect or consequential loss" is not a term of art under Japanese law, a provision excluding such losses is generally construed as the exclusion of "special damages". Such a contract provision is basically considered valid. However, if a breach of contract occurs by fraud, wilful conduct, or the reckless or gross negligence of the party in breach, the courts might intervene by implying a condition that the limitation of liability clause would not apply under those circumstances.

31 Are contractually agreed limits on – or exclusions of – liability effective and how readily do claims in tort or delict avoid them? Do they not apply if there is fraud, wilful misconduct, recklessness or gross negligence: (a) if the contract is silent as to such behaviour; or (b) if the contract states that they apply notwithstanding such behaviour? If so, what causation is required between the behaviour and the loss?

Parties to a construction contract can agree on exclusion or limitation of liability for tort claims in addition to contractual claims.

In general, the courts are likely to restrict the application of such exclusion or limitation of liability provisions based on the good faith principle or public policy if the party in breach is found to be perpetuating a fraud, wilful misconduct, recklessness or gross negligence

The causation required between the behaviour and the loss follows that for the general principle of tort, which is reasonable causation between them.

Liens

32 What right does a contractor have to claim a lien (or similar) in the works it has carried out? If so, what are the limits of the right if, for example, the employer has no interest in the site for the permanent works? How is the right recognised and enforced?

Under the Civil Code, if a main contractor does not obtain the ownership of the works in accordance with the relevant provisions in a contract or the relevant court decisions, a main contractor can generally claim a right of retention of the works until a main contractor receives full payment of the due amount of the contract price. A main contractor can claim such retention against the third parties in addition to against an employer. It is a controversial issue whether a subcontractor can claim a right of retention of the works against an employer even if an employer has paid the contract price to a contractor.

Subcontractors

33 How do conditional payment (such as pay-when-paid) provisions operate under the law of your jurisdiction (including interpretation rules, any good faith principles and laws on unfair contract terms)?

"Pay-when-paid" provisions and similar conditional payment clauses are not prohibited under Japanese law. However, they must comply with the Construction Business Act (Act No. 100 of 1949, as amended) that require the main contractor:

- to pay the subcontractor within one month, and as soon as possible, from the date of receipt of the payment from the employer; and

- if they hold a licence as a "special construction business operator", to pay within 50 days, and as soon as possible, from the date when the subcontractor demands taking over the works to the main contractor after the inspection of the said works.

34 May a subcontractor claim against the employer for sums due to the subcontractor from the contractor? How are difficulties with the merits and proof of the subcontractor's claim addressed, including any rights the contractor has to withhold payment? What if aspects of the project suggest that the law of your jurisdiction should not apply (eg, the parties to both the main contract and the subcontract have chosen a foreign law as the governing law)?

In general, a subcontractor cannot claim directly against an employer as there is no contractual relationship between them. However, if a subcontractor can prove a contractor is impecunious, the subcontractor can exercise a contractor's right against an employer to claim payments and is entitled to receive direct payments from an employer.

It is unclear whether such a claim is permitted where both the main contract and the subcontract have chosen a foreign law as governing law. While there exists an old lower court judgment that affirmed its application as the rule of lex fori, it is uncertain whether this view will be followed by other courts.

35 May an employer hold its contractor to their arbitration agreement if their dispute concerns a subcontractor (there being no arbitration agreement between the contractor and the subcontractor or no scope for joining two sets of arbitral proceedings) or can the contractor, for example, require litigation between itself, the employer and the subcontractor? Does it matter if the arbitration agreement does not have its seat in your jurisdiction?

An employer may hold its contractor to their arbitration agreement with respect to any dispute between the employer and the contractor, even if the dispute concerns a subcontractor who is not a party to the arbitration agreement. Under those circumstances, the contractor cannot require a litigation between itself, the employer and the subcontractor, as any dispute between the employer and contractor has to be referred to arbitration.

It is unlikely that the fact that the arbitration agreement provides for a foreign seat would affect this conclusion.

Third parties

36 May third parties obtain rights under construction contracts? How readily can those connected with the employer (such as future or ultimate owners) bring claims against the contractor in respect of (a) delays and (b) defects? To what extent are exclusions and limitations of liability in the construction contract relevant?

Generally, since contractual rights exist only between the parties to a construction contract, third parties will not obtain any rights under such construction contract unless such rights are expressly conferred on the third parties in the contract and the third parties show their intention to enjoy the benefit of the contract.

Under Japanese law, an employer can assign the entire contract or certain rights thereunder to a third party subject to not changing any rights for the contractor. Since the content of the rights will remain unchanged in such circumstances, the contractor can raise the same defences against such third party as it would have been entitled to raise vis-à-vis the initial employer, including exclusions and limitations of liability.

37 How readily (absent fraud, wilful misconduct, recklessness or gross negligence) can those connected with the contractor (such as affiliates, directors or employees) face claims in respect of (a) delays (b) defects and (c) payment? To what extent are exclusions and limitations of liability in the construction contract relevant?

Parties connected with a contractor but who are not parties to the construction contract would generally not be subject to such claims by an employer. Except in instances of fraud, wilful misconduct, reckless or gross negligence, an employer can rarely bring a tort claim against parties connected with a contractor. Contract provisions pertaining to exclusions and limitations of liability are generally irrelevant to such tort claims against parties that are not parties to the construction contract.

Limitation and prescription periods

38 What are the key limitation or prescription rules for claims for money and defects (and insofar as you have a mandatory decennial liability (or similar) regime, what is its scope)? What stops time running for the purposes of these rules (assuming the arbitral rules are silent)? Are the rules substantive or procedural law? May parties agree different limitation or prescription rules?

Japanese law provides for:
- a five-year prescription period from the time when a creditor acknowledges that it is possible to exercise its rights; and
- a 10-year prescription period from the time when it is objectively possible for a creditor to exercise its rights.

Events that temporarily suspend the prescription periods include:
- filing a claim to the court;
- filing an application for enforcement to the court;
- a court order of interim measures including seizure of assets;
- a formal demand;
- parties' agreement after the prescription period starts; and
- filing an arbitration proceeding.

Events that renew the prescription periods include:
- confirmation of rights by a final judgment;
- completion of enforcement procedures; and
- approval of rights by an obligor.

Prescription periods under Japanese law are considered to have a substantive legal effect. Where the prescription period has expired as to a claim, that claim would be extinguished.

Prescription periods are mandatory rules, and cannot be shortened or extended by party agreement before the prescription periods starts, though parties can agree to stay the running of the period.

Other key laws

39 What laws apply that cannot be excluded or modified by agreement where the law of your jurisdiction is the governing law of a construction contract? What are the key aspects of, say, the FIDIC Silver Book 1999 that would not operate as its plain words suggest?

Where Japanese law is the governing law of a construction contract, mandatory rules and laws cannot be contracted out of by party agreement. In general, mandatory laws are those pertaining to public policy such as competition laws and due process.

The FIDIC books are rarely used in domestic construction projects.

40 What laws of your jurisdiction apply anyway where a foreign law governs a construction contract? What are the key aspects of, say, the FIDIC Silver Book 1999 that would not operate as its plain words suggest?

Even if the governing law of a construction contract is not Japanese law, mandatory rules and laws in Japan will apply within its territory. In general, mandatory laws are those pertaining to public policy such as competition laws and due process.

Enforcement of binding (but not finally binding) dispute adjudication board (DAB) decisions

41 For a DAB decision awarding a sum to a contractor under, say, sub-clause 20.4 of the FIDIC Red Book 1999 for which the employer has given a timely notice of dissatisfaction, in an arbitration with its seat in your jurisdiction, might the contractor obtain: a partial or interim award requiring payment of the sum awarded by the DAB pending any final award that would be enforceable in your jurisdiction (assuming the arbitral rules are silent); or interim relief from a court in your jurisdiction requiring payment of the sum awarded by the DAB pending any award?

Under the Arbitration Act (Act No. 138 of 2003, as amended), enforcement is limited to an arbitral award that is a final determination of at least some of the issues in dispute. Therefore, an interim award requiring payment of a sum awarded by the DAB pending any final awards is not enforceable.

Courts and arbitral tribunals

42 Does your jurisdiction have courts or judges specialising in construction and arbitration?

The Tokyo and Osaka District Courts have specialised divisions for construction-related cases. There is currently no specific division in the Japanese courts specialising in arbitration-related cases. However, the Ministry of Justice is currently in the process of preparing a bill for the amendment of the Arbitration Act (Act No. 138 of 2003, as amended) that, if passed, will presumably confer on the Tokyo or Osaka District Courts concurrent jurisdiction in certain cases if the seat of arbitration is within Japan, the respondent has its domicile or office in Japan, or the subject of the claim or asset to be seized is within Japan.

43 What are the relevant levels of court for construction and arbitration matters? Are their decisions published? Is there a doctrine of binding precedent?

As with most civil cases, the district courts and the summary courts have jurisdiction as the courts of first instance for construction-related cases, with the district courts handling claims above ¥1.4 million. For arbitration-related cases, the district courts have jurisdiction as the courts of first instance.

Save for cases conducted in private in accordance with relevant laws, all decisions rendered in Japanese courts are accessible to the public, and many but not all of them are published on the court website and/or by private service providers.

There is no general doctrine of precedent in the Japanese judicial system, but the conflict against a Supreme Court precedent may constitute the ground to file a petition for acceptance of a final appeal. As such, in practice, Supreme Court decisions have been respected as precedents by lower courts.

44 In your jurisdiction, if a judge or arbitrator (specialist or otherwise) has views on the issues as they see them that are not put to them by the parties, can they raise them with the parties? Is the court or arbitral tribunal permitted or expected to give preliminary indications as to how it views the merits of the dispute?

While the Japanese court system applies the adversarial system in principle, under the Code of Civil Procedure (Act No. 109 of 1996, as amended) a presiding judge may independently ask questions even on issues not raised by the parties to clarify the issues. A judge may also give preliminary indications of the merits of the case, and it is not unusual for a judge to do so in order to encourage settlement in particular at the later stage of litigation.

For an arbitrator, there is no statutory restriction on raising questions and/or giving preliminary indications of the merits of the case during arbitral procedures.

45 If a contractor, say, wishes to arbitrate pursuant to an arbitration agreement, what parallel proceedings might the employer bring in your jurisdiction? Does it make any difference if the dispute has yet to pass through preconditions to arbitration (such as those in clause 20 of the FIDIC Red Book 1999) or if one of the parties shows no regard for the preconditions (such as a DAB or amicable settlement process)?

If an employer initiates a lawsuit in Japanese courts contrary to the existence of the arbitration agreement, it will be dismissed without prejudice upon application by a contractor, unless: (i) the arbitration agreement is invalid; (ii) it is impossible to conduct arbitral proceedings; and (iii) the application was filed after a contractor submitted its argument on the merits of the case in arbitration. This is the case even while passing through contractual preconditions to arbitration or where the preconditions have not been satisfied.

If a tribunal finds its jurisdiction despite a contractor's failure to take necessary steps required as preconditions to arbitration, an employer can apply to the courts within 30 days of the receipt of tribunal's ruling for a review of the tribunal's jurisdiction.

46 If the seat of the arbitration is in your jurisdiction, might a contractor lose its right to arbitrate if it applied to a foreign court for interim or provisional relief?

The Arbitration Act (Act No. 138 of 2003, as amended) stipulates that an arbitration agreement will not refrain a contractor from filing a petition for an interim or provisional order from a Japanese court. There is no reason to think that there would be any difference if such relief is sought in a foreign court having jurisdiction.

Expert witnesses

47 In your jurisdiction, are tribunal- or party-appointed experts used? To whom do party-appointed experts owe their duties?

For construction-related cases, it is common practice in Japan to use either tribunal- or party-appointed experts due to the highly technical nature of issues such as defects, delay and damages. Generally, party-appointed experts have to provide an independent opinion even though party-appointed experts are under contractual obligations to appointing parties. The conduct of party-appointed experts is governed by the contract with appointing parties and the ethical or statutory codes of conduct, if applicable based on the professional qualifications held by party-appointed experts. In practice for international issues including international arbitration, the importance of independence and impartiality of party-appointed experts is well recognised.

State entities

48 Summarise any specific limitations or requirements that apply when the employer is a state entity or public authority (including, for example, public procurement rules, limits on rights to suspend or terminate, excluded lien rights and arbitrating – as well as enforcing an award – against such an employer).

If the employer is a public authority in Japan, the relevant statutory laws and regulations for public procurement apply. These laws and regulations ensure economic efficiency, as well as fairness between the suppliers and the general public.

A construction contract will be awarded through bidding procedures, which are general competitive bidding and designated competitive bidding. In an exceptional case under strict conditions, a construction contract might be awarded directly, without a bidding procedure.

There is no domestic legislation explicitly prohibiting enforcement of an arbitral award against Japanese public authorities.

Settlement offers

49 If the seat of the arbitration is in your jurisdiction, on what basis can a party make a settlement offer that may not be put before the arbitral tribunal until costs fall to be decided?

There are no specific provisions or principles in Japanese law relevant to this. However, in practice for international issues including international arbitration, the principle of "without prejudice" privilege as it relates to good-faith settlement efforts is widely recognised. Therefore, an arbitral tribunal seated in Japan would likely uphold it in an international arbitration case and allow disclosure of any settlement offer made on a without prejudice basis – especially if expressly so – only as to costs and after the decision on the merits is made.

Privilege

50 Does the law of your jurisdiction recognise "without prejudice" privilege (such that "without privilege" communications are privileged from disclosure)? If not, may it be agreed that a sum is payable if communications to try to achieve a settlement are disclosed to a court or arbitral tribunal?

Japanese law does not expressly recognise the concept of "without prejudice" privilege. However, in practice for international issues including international arbitration, the principle of without prejudice privilege as it relates to good-faith settlement efforts is widely recognised. Therefore, an arbitral tribunal seated in Japan would likely uphold it in an international arbitration case. In addition, parties can agree contractually to a non-disclosure agreement in which any breaching party must pay a sum to the other if settlement communications are disclosed to a court or arbitral tribunal.

51 Is the advice of in-house counsel privileged from disclosure under the law of your jurisdiction? Is the relevant law characterised as substantive or procedural law?

As a general rule, Japanese law does not recognise the general concept of attorney-client privilege as admitted in common law. However, such carve-outs are generally not needed in Japanese civil procedure as the Civil Procedure Code (Act No. 109 of 1996, as amended) provides for the protection against the request for document production. For example, a party can withhold a document from disclosure if it contains information obtained by qualified professionals through the performance of their duties. Although there is no relevant case law, the Code itself does not explicitly exclude in-house counsel who holds a legal qualification in Japan from qualified professionals.

Guarantees

52 What are the requirements for a guarantee under the law of your jurisdiction? Are oral guarantees effective?

A guarantee must be in writing or recorded in an electronic form. Otherwise, it will be invalid and unenforceable.

Besides, there are special rules for a guarantee where a guarantor is not a judicial person. First, a revolving guarantee that covers unidentified obligations within a certain specific scope must include the maximum amount of obligations, without which it is ineffective. Further, a guarantee or a revolving guarantee that covers the obligation which is incurred from a loan transaction for business must be preceded by production of a notarised document certifying a guarantor's intention to bear guarantee obligations.

53 Under the law of your jurisdiction, will the guarantor's liability be limited to that of the party to the underlying construction contract, if the guarantee is silent? Can the guarantee's wording affect the position?

Under the Civil Code (Act No. 89 of 1896, as amended), a guarantor's obligation is limited to that of the principal obligor.

In general, parties can broaden the scope of the guarantee by using a revolving guarantee that covers unidentified obligations within a certain specific scope. However, in such a case, parties should take note of specific provisions in the law that protect guarantors who are not judicial persons if applicable.

54 Under the law of your jurisdiction, in what circumstances will a guarantor be released from liability under a guarantee, if the guarantee is silent? Can the guarantee's wording affect the position?

It depends on the scope of the guarantee, for which the Japanese courts will seek to determine the guarantor's real and actual intentions at the time of the provision of the guarantee, primarily with reference to the wording of the guarantee.

Based upon the Supreme Court decision (Case No. 126 (O) of 1971), for example, absent exceptional circumstances, a guarantor who provided an employer with a guarantee for a contractor will be deemed to agree to bear responsibility as a guarantor even for repayment of an advance payment that an employer will claim after terminating a construction contract on the grounds of a contractor's breach of contract.

On-demand bonds

51 If an on-demand bond is governed by the law of your jurisdiction on what basis might a call be challenged in your courts as a matter of jurisdiction as well as substantive law? Assume the underlying contract is silent on when calls may be made.

A call of an on-demand bond governed by Japanese law will be subject to the principle of good faith and the prohibition of abuse of rights, both of which are provided for in the Civil Code (Act No. 89 of 1896, as amended).

56 If an on-demand bond is governed by the law of your jurisdiction and the underlying contract restrains calls except for amounts that the employer is entitled to (such as sub-clause 4.2 of the FIDIC Red Book 1999), when would a court or arbitral tribunal applying your jurisdiction's law restrain a call if the contractor contended that: (i) the employer does not have an entitlement in principle; or (ii) the employer has an entitlement in principle but not for the amount of the call?

There are no specific statutory laws or published court decisions with regard to the restraint of a call in such circumstances. The Japanese courts will interpret the relevant wording of an on-demand bond taking into consideration the commercial custom to find the parties' real and actual intentions at the time of provision of such on-demand bond.

A call will be subject to limitation due to abuse of rights or contravention of public policy under the Civil Code (Act No. 89 of 1896, as amended).

Further considerations

57 Are there any other material aspects of the law of your jurisdiction concerning construction projects not covered above?

Contract interpretation guided by Japanese law enquires into the "true meanings" a party intended to give to a contract, which may involve a review of extrinsic evidence, especially where the language of the contract itself is not clear. It is therefore important to keep good records, including those for pre-contractual negotiations. It is also advisable to clearly define in a contract the meaning of concepts that are not native to Japanese law, such as representations and warranties, as well as indemnities.

Aoi Inoue

Anderson Mōri
& Tomotsune

Aoi Inoue is a partner and co-head of international arbitration at Anderson Mori & Tomotsune. He specialises in international arbitration and litigation. He represents clients in a wide range of business disputes, including sales of goods, joint venture, distributorship, licensing, franchising, construction projects, complex financial products, labour and employment and product liability.

He has acted as counsel in a number of international arbitrations under various rules including the ICC, SIAC, HKIAC, JCAA, VIAC and UNCITRAL. He also serves as arbitrator and has been appointed to the panel of arbitrators of the JCAA, KCAB INTERNATIONAL and Japan Sports Arbitration Agency (JSAA). He has been recognised as a leading arbitration lawyer in *Who's Who Legal: Arbitration, Who's Who Legal: Japan, The Legal 500: Asia Pacific, Best Lawyers* and *Benchmark Litigation Asia-Pacific.*

He currently serves as Vice-Chair of the Dispute Resolution and Arbitration Committee of the Inter-Pacific Bar Association (IPBA), and Chair of the Research & Study Committee of the Japan Association of Arbitrators (JAA).

zAoi Inoue received his LLB from the University of Tokyo, and holds an LLM from Columbia Law School. He is admitted to practise in Japan and New York. He worked for Hughes Hubbard & Reed LLP, a New York law firm, as a visiting attorney (2010 to 2011) before he resumed his position at Anderson Mori & Tomotsune. He co-authored *Law and Practice of International Commercial Arbitration* (Maruzen-Yushodo, 2016).

David MacArthur

Anderson Mōri
& Tomotsune

David MacArthur is a specialist in international arbitration with over 18 years' experience in both common law and civil law jurisdictions. Prior to joining Anderson Mori & Tomotsune as co-head of the International Arbitration practice in January 2021, David was a leading member of a globally ranked practice where he represented clients in dozens of international arbitrations across Asia, Europe and North America. His case portfolio includes both commercial and investor-state disputes in a wide variety of complex and high-stakes disputes in the automotive, aircraft, IP, life sciences and medical, post-M&A, online gaming, shipbuilding and construction, telecommunications and other industries and dispute types. David is also an arbitrator listed in the panels of the HKIAC, KCAB, JCAA, WIPO and AIAC. Recognised in *Who's Who Legal, Chambers and Partners, The Legal 500* and other peer-reviewed rankings, David has served in a number of leadership and influence positions, including as founding co-chair of KCAB Next, a professional development organisation under the auspices of KCAB INTERNATIONAL and as a member of the Silicon Valley Arbitration and Mediation Center's Asia Task Force. He is also proficient in Japanese and Korean in addition to his native English.

Masahiro Yano

Anderson Mōri
& Tomotsune

Masahiro Yano is a senior associate of Anderson Mori & Tomotsune based in Osaka office. He belongs to its international arbitration team. He specialises in international arbitration and litigation. He represents clients in a wide range of business disputes, including sales of goods, joint venture, distributorship, post-M&A, licensing, construction, banking, complex financial products, and product liability, as well as sports disputes.

He received his LLB and JD from the University of Tokyo, and holds an LLM from Queen Mary University of London. He is admitted to practise in Japan.

Tatsuhiko Makino

Anderson Mōri
& Tomotsune

Tatsuhiko Makino, FCIArb is an associate of Anderson Mori & Tomotsune's international arbitration team. His area of practice is cross-border dispute resolution, with special focus on international arbitration. He has represented clients in disputes between shareholders, joint ventures, and suppliers and distributors. The areas of dispute he represented include construction, product liability as well as insurance.

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Otemachi Park Building,
1-1-1 Otemachi
Chiyoda-ku,
Tokyo 100-8136,
Japan
Tel: 81-3-6775-1000

www.amt-law.com

Aoi Inoue
aoi.inoue@amt-law.com

David MacArthur
david.macarthur@amt-law.com

Masahiro Yano
masahiro.yano@amt-law.com

Tatsuhiko Makino
tatsuhiko.makino@amt-law.com