A foreign owner contracting with a Japanese construction company to build facilities in Japan, whether a hotel, a manufacturing facility, a process plant or otherwise, faces a number of challenges.

Japanese contractors will often insist on using one of the various standard forms of contract used in Japan. On the whole, these forms are contractor-friendly. It is possible to negotiate with the contractors to use a bespoke form that affords greater protections to the owner, although this requires patience and finesse. That said, when the negotiations are concluded, the owner will have a much better agreement and the contractor will have a valuable working knowledge of the owner’s expectations and its own obligations, which will help to facilitate the project’s timely and successful completion.

**Standard Forms of Contract Used in Japan**

The standard form of contract that a foreign owner building a major facility in Japan is most likely to encounter is the General Conditions of Construction Contract (Minkan Rengo Kyoutei Koji Ukeoi Keiyaku Yakkan) (the “General Conditions”), prepared by a consortium of four professional associations of architects and contractors for purposes of private construction. A few provisions from this form are examined in the following section.

Other standard forms used in Japan include the General Conditions for Design Work and Supervision Contract (prepared by the same consortium that prepared the General Conditions), the General Conditions for Design and Build Contract (prepared by the Japan Federation of Construction Contractors), the General Conditions of Standard Public Construction Contract (prepared by the Central Council for Construction Contracting Business within Japan’s Ministry of Land, Infrastructure, Transport, and Tourism), and the ENAA (Engineering Advancement Association of Japan) Model Form of Agreement.
and General Conditions. English translations of all of these forms are available.

**The General Conditions**

Set out below are a few illustrative examples of contractor-friendly provisions in the General Conditions:

In regard to ambiguities in the design documents or discrepancies between the specifications and drawings or between other documents and in regard to unforeseen site conditions, the General Conditions provides that an administrative architect, appointed by the owner, is to give written instructions to the contractor; provided, however, that if “it becomes necessary to make changes to the Work or to adjust the Contract Time or the Contract Sum, the matter shall be agreed upon through consultations among the Owner, the Administrative Architect, and Contractor.” This reflects a not uncommon approach in Japanese contract drafting, which is to leave certain risk allocations for later discussion and agreement, if the need should arise. Needless to say, the uncertainty involved in this approach is an owner risk.

In regard to intellectual property rights, the General Conditions provide that the owner bears the costs of procuring third-party intellectual property rights for materials, equipment or construction methods where such items are specified in the design documents but without stating that they are subject to third-party rights and where the contractor was not aware of the third-party rights. This places squarely on the owner the risk of unidentified third-party intellectual property rights in materials, equipment and methods specified in the design documents. In addition, the General Conditions are silent as to the ownership of intellectual property rights developed in the course of performing the work.

**Negotiating with Japanese Contractors**

Japanese contractors will often insist on using the General Conditions, emphasizing that they are standard in Japan and conform to Japanese law. While this may be true, there is no requirement that they be used.

In Japan, freedom of contract is generally respected, subject to the requirements of applicable laws. A law called the Construction Business Act (the “CBA”) provides that the parties to a construction agreement are to account for and record 14 specified items in a written document, which is to be signed or impressed with seals. The CBA, however, is an administrative law, not a civil or commercial law. For that reason, a breach of this provision of the CBA will not necessarily result in the agreement’s being held invalid. That said, Japanese contractors almost always insist on including the 14 specified items. They are:

- scope/content of the works;
- amount of the contract fee/price;
- date for the commencement and completion of the works;
- provisions regarding advance payment, if any;
- provisions regarding design changes, delay, or suspension of the works;
• provisions regarding force majeure;
• changes in the contract fee or the content of the works based on fluctuations or changes in prices, etc.;
• compensation for losses or damage to a third party;
• supplied materials and leased machinery by the owner, if any;
• date and method for the inspection of the works;
• date and method for payment;
• guarantee and insurance agreement, if any;
• interest for arrears, damages for breach of contract, etc.; and
• the method of dispute resolution.

Negotiations with Japanese contractors for domestic projects can take time. If the contractors are asked to depart significantly from the General Conditions, they often need to have internal discussions and obtain management approval. If the project is sizable, usually this can be accomplished, although it may take time. Also, it sometimes happens that the domestic contract teams are unfamiliar with the details included in foreign construction agreements such as, for example, lengthy clauses relating to intellectual property rights. Thus, the owner will often need to explain what unfamiliar clauses mean and why they are important. This process can be helpful not only in persuading the contractors to accept the more detailed provisions but also later when the work begins because the contractors will be more knowledgeable as to what the agreement says and what their obligations are.

Notably, it is nearly impossible to persuade a Japanese contractor to enter into a construction agreement for a domestic project that is not governed by Japanese law. In addition, the domestic teams at Japanese contractors typically are not as sophisticated with English as their counterparts working on international projects. Thus, it is likely that Japanese will need to be the prevailing language of the agreement, although there can be an English language column or a separate English version for convenience.

The majority of construction disputes in Japan are resolved through litigation in court. There are no restrictions, however, on resolving disputes by way of alternative dispute resolution. The most commonly used arbitration forum for construction disputes in Japan is that of the Construction Work Disputes Committees (the “CWDC”). Every prefecture has its own CWDC, with the central CWDC located in the Ministry of Land, Infrastructure, Transport and Tourism. Notably, Japanese is the only language permitted in CWDC arbitration.

If an owner prefers to arbitrate in English, this is possible by providing for the use of an independent arbitration association, such as the Japan Commercial Arbitration Association (the “JCAA”). Arbitration using the JCAA or another independent association, however, is uncommon in the construction industry. Thus, if this is the owner’s preference, the contractors will need to be persuaded when the construction contract is negotiated.
A Few Additional Points of Japanese Law

Set out below are a few additional points of Japanese law important in the context of drafting construction agreements:

In Japan, pay-when-paid clauses are generally unenforceable. Under the CBA, the primary contractor is to pay its subcontractors within one month of receiving payment from the owner. In addition, the primary contractor is to pay its subcontractors within 50 days of the date that subcontracted works pass inspection and are transferred to the primary contractor. Some courts have held that if an owner becomes insolvent and is unable to pay the primary contractor, subcontractor fees become due and payable and the primary contractor cannot refuse to pay its subcontractors.

Liquidated damages clauses are generally enforceable. Under the Civil Code of Japan, “[t]he parties may agree on the amount of liquidated damages with respect to the failure to perform an obligation. In such case, the court may not increase or decrease the amount thereof.” If a liquidated damages clause requires a disproportionately high amount of damages, however, courts do have the power to set aside the clause. In considering whether to do so, they will consider the difference in the negotiating positions of the parties, the underlying purpose of the amount of the liquidated damages and the amount of damages actually incurred. Notably, courts rarely set aside liquidated damages clauses. Where they are set aside, the owner may bring a claim for compensatory damages, which requires that the amount of actual damages be proven.

Exclusive remedies provisions are rarely used in Japanese construction agreements. This is probably because if a liquidated damages clause is included, courts generally assume that the parties intended liquidated damages to be the sole remedy unless expressly set out otherwise.

As to matters of contract interpretation, where a term or condition is ambiguous, courts will consider pre-contract communications and post-contract conduct if necessary to establish the parties’ intent. In addition, courts have broad discretion to hold invalid and unenforceable terms and conditions so unfair or reflecting such unequal bargaining power as to be deemed against public policy, public order and/or morality. Typically, only the offending terms or conditions are held invalid and unenforceable, not the entire agreement.

Conclusion

Persuading Japanese contractors to move away from the General Conditions and accept terms more standard in international construction contracts can be challenging but is well worth the effort, both in terms of achieving a more owner-friendly contract and in terms of familiarizing the contractors with the obligations that they are being asked to undertake, which can facilitate a smoother working relationship.
and a better end result.