

Outline of MLIT Report on Advisory Committee Findings on Legal Schemes for Japanese Privatized Airports

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1. Introduction

On March 11, 2022, the Ministry of Land, Infrastructure, Transport and Tourism (the "MLIT") released the "Summary Report Regarding Advisory Committee Findings on Legal Schemes for Japanese Privatized Airports" (the "Report"). The Report first reconfirms the objective of airport privatization using a form of concession (such structure is referred to herein as "airport concession"), and then further reviews the deal structures of airport concessions in order to consider the ideal airport concession agreement, taking into account the current situation due to the COVID-19 pandemic. Specifically, in consideration of such situation, the Report proposes a new approach to airport concessions in terms of (i) extension of the concession period under airport concession agreements, (ii) payment structure of concession fees, (iii) introduction of new risk-sharing clauses and (iv) risk-sharing between grantor and grantee in case of *force majeure* circumstances as applicable to *Kongou-gata* schemes.¹

This newsletter will provide an outline on the content of the Report.

2. Background: Measures Implemented by MLIT in Response to the COVID-19 Pandemic

As further described in our Finance Law Newsletter issued on March 4, 2021, titled "[Japan Eases Airline Slot Usage Requirements in Pandemic Response](#)", the MLIT has implemented various measures to support airlines, airports and other related companies in the air transport industry amid the continuing severe business conditions caused by significant declines in air passenger demand. Among these measures, for privatized airports managed by MLIT as grantor of the airport concession (referred to herein as "privatized airports"), MLIT may offer privatized airports interest-free loans for the development of airport facilities, grant an extension on payment of concession annual fees for a certain period, grant an extension of the concession period, and/or grant relief from certain obligations under the airport concession agreement.

However, the Report states that MLIT has received feedback that (i) such support measures themselves are insufficient to compensate for the damage suffered by airport operators due to *force majeure* circumstances such as COVID-19, and (ii) insufficient consideration is given to measures in the event of a *force majeure*

¹ There are three general structures in Japanese PFI projects: (i) public sector entity (Grantor) commits to pay fees for services provided by a private sector entity (Grantee), (ii) private sector entity (Grantee) charges users of the targeted business under its concession agreement without any payment from the public sector entity (Grantor), and (iii) private sector entity (Grantee) charges users of the targeted business under its concession agreement while the public sector entity (Grantor) also (to a certain extent) commits to pay fees for services provided by the private sector entity (Grantee). The structure described in item (iii) above is called "*Kongou-gata*" scheme.

situation especially as applicable to *Kongou-gata* schemes.² *Kongou-gata* schemes are being considered for adoption to promote airport concessions at government-managed airports in the future.³

A) Agreed Extension of Concession Period

Under Japanese airport concession agreements with respect to privatized airports, in the event that, due to *force majeure* circumstances, the grantee incurs an increase in costs or other damages, or all or part of the business is suspended, the grantee may request a consultation with MLIT to extend the concession period only when it is necessary to recover the increased costs or damages caused by such *force majeure* circumstances. Through such consultation process, MLIT and the grantee may agree on an extension to the concession period.

Although the maximum limit for extension to the concession period is set at five years for privatized airports (except for Kumamoto Airport), the Advisory Committee has recommended that, in consideration of the impact of *force majeure* circumstances such as COVID-19 in the future, it is desirable to consider a mechanism that allows for flexible changes in the concession period taking into consideration damages that may occur in the future, as well as combining such extension with other support measures as further described in the following sections of this newsletter.

B) Payment Structure of Concession Fees

The Guidelines on the Right to Operate the Public Facility, etc. and the Public Facility, etc., Operating Project (revised on June 18, 2021; referred to herein as the "Guidelines") stipulate that "when considering the objective of PFIs, as the utilization of private finance, it is not desirable for the public sector side to bear the financial risks, and from the viewpoint of promoting introduction of a mechanism whereby the private sector will bear the financial risks (such as the operating right holder receiving a loan from a financial institution or the like), a lump-sum payment should be considered for the payment of concession fees. Even if installment payments are to be adopted, efforts should be made to incorporate a lump-sum payment of a certain amount (for the initial portion)." (Guidelines, page 35).⁴

On the other hand, the Report also notes opinions that it is desirable that payments by airport operators should be made in installments, and the amount of each payment should not be fixed, but should instead be linked to the profits of operators or passenger numbers in order to reduce the financial risk borne by operators in the event of a sudden deterioration in the business environment due to a *force majeure* circumstance such as COVID-19. Taking into consideration such opinions, the Report also points out that it is advisable to grant payment by installments payment structures in a flexible manner in accordance with the background and circumstances of each project. The Report also suggests installment payment structures could also include the above-mentioned methods such as linking the installment payments with the profits of the operator or passenger numbers. However, the Report mentions that these figures also fluctuate depending on changes in the external environment and the management efforts of the airport operator.

² The Japanese government is now in discussions on whether *Kongou-gata* should be adopted in future airport concession deals.

³ In the Report, certain business operators were surveyed by way of a questionnaire, and discussions were held based on the opinions provided through the questionnaire.

⁴ https://www8.cao.go.jp/pfi/hourei/guideline/pdf/en_uneiken_guideline.pdf

C) Introduction of New Risk-Sharing Clauses in Airport Concession Agreements

As mentioned in the beginning of Section 2. above, MLIT may offer privatized airports interest-free loans for the development of airport facilities, grant an extension on payment of concession annual fees for a certain period, grant an extension of the concession period, and/or provide relief from certain obligations under the airport concession agreement. In the Report, it has been recommended that the introduction of (i) provisions on profit/loss sharing, which is also proposed in the Guidelines, and (ii) provisions on interest-free loans by MLIT, which is recognized in the Act on Promotion of Private Finance Initiative (Act No. 117 of 1999; referred to herein as the "PFI Act"), should be considered on a case-by-case basis, as concrete measures to compensate operators for damages suffered upon occurrence of a *force majeure* event.

The clause relating to profit sharing is described as "a clause under which the operating right holder pays money to the administrator if the profit for each business year exceeds the standard provided in advance, in the corresponding amount" (page 23 of the Guidelines).

D) Risk-Sharing Between Grantor and Grantee in *Force Majeure* Circumstances in *Kongou-gata* Schemes

The Report notes that some airports governed by MLIT, that are not currently privatized, are experiencing difficulty operating their businesses on stand-alone bases. The Report states that *Kongou-gata* scheme may be adopted when introducing an airport concession scheme at such airports. However, the Report has identified that the measures which are currently adopted in the privatized airport concession agreement to compensate operators for damages in the event of *force majeure* circumstances may not be appropriate for *Kongou-gata* schemes.⁵

First, because the maximum public burden of MLIT during the project period is determined at the time of the initial public offering of the *Kongou-gata* scheme, this scheme may not necessarily allow additional public burden to be imposed for the extended concession period, even if the concession agreement is extended. Specifically, at the time of the initial public offering, airport concession projects must be approved by the Diet as a budgetary measure with a limitation on the amount of public expenditure during the airport concession period, and there is additionally a limitation on the duration of such expenditure obligations as permitted under Article 68 of the PFI Act.⁶ Payments of fees by MLIT to the grantee for services provided by the grantee under extended concession periods are not included in the budgetary measures approved by the Diet. Accordingly, in order to commit the grantor to make payments of fees for services provided by the grantee under the extended concession periods, a resolution made by the Diet is additionally required. Therefore, at the time of the execution of the airport concession agreement, the grantor's payment obligations are not necessarily guaranteed to apply during concession periods that are extended due to the occurrence of future *force majeure* events.

Second, even if grantees are allowed suspension of their obligations to make certain investments in facilities under the airport concession agreements, it is expected that the related-investment amount to be paid by the

⁵ It is reported that after excluding depreciation costs, at least 2.7 million passengers per year are necessary to operate airport facilities as an independent business entity (Kato, K., Uemura, T., Indo, Y., Okada, A., Tanabe, K., Saito, S., Oguma, H., Yamaguchi, M., Shiomi, E., Saegusa, M., Migita, K. (2011). Current accounts of Japanese airports. *Journal of Air Transport Management*, 17(2), 88–93. <https://doi.org/10.1016/j.jairtraman.2010.07.001>).

⁶ The period during which the grantor should perform its obligations is limited to 30 years or less from the fiscal year in which the budgetary measure is approved.

grantees will be relatively small for airports where *Kongou-gata* scheme will be adopted, as compared to such investment amounts for stand-alone airports. Accordingly, it is considered that suspending the grantees' investment obligations may ultimately be of limited effectiveness to improve the grantees' cash flow.

As a measure to address these concerns, the Report recommends that, with the viewpoint of ensuring grantees are encouraged to resolve difficulties themselves through management efforts, it is desirable to first consider the introduction of clauses related to profit/loss sharing and clauses related to non-interest loans by MLIT on a project-by-project basis, while taking into consideration the need to clarify risk-sharing between the public and private sectors in the same way as for privatized airports managed on a stand-alone basis.

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