

## THE LAW AND FINANCE OF INFRASTRUCTURE INVESTMENT

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### ABSTRACT

Institutional design facilitates the investment of private capital in infrastructure. The Article deals with concessions, which have been a major format for infrastructure privatization in Japan since their legislation in 2011. It argues that the Japanese government, faced with mounting public debt, walks a thin line between attracting private capital and securing public interest in infrastructure under private operation. By comparing concessions with stock sales, the mainstream form of privatization until the legislation, the Article shows that while concessions have advantages in terms of economics and public interest control, they may hinder the strategic growth of private enterprises by limiting operating flexibility. Stock sales give greater flexibility to privatized infrastructure and require more sophisticated regulations on entry, pricing, and equal footing than concessions, which provide a more controlled competitive environment.

To extract the best of these two worlds and promote the use of private capital in infrastructure investment, the Article proposes the use of concessions for corporatized infrastructure, which are government-owned corporations converted from government entities. Through this two-layered form of privatization, the government can resume the privatization of corporatized infrastructure, whose stock sales have lagged since the vigorous shareholder activism of the 2000s. The Article also argues that the use of limited partnerships as a vehicle for concessions will promote investment by institutional investors, which have been discouraged by a requirement that concessionaires have operating capabilities. While providing investor protection for limited partners under fund governance, the vehicle will give the most operating responsibilities to general partners. Further, to improve consistency among the design, building, and operation of

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infrastructure by means of private capital, the Article proposes that the purview of concessions be expanded to include the building of new infrastructure elements, as opposed to merely the operation of existing ones.

#### TABLE OF CONTENTS

I.	INTRODUCTION .....	52
II.	STRUCTURE OF CONCESSIONS.....	61
	A. Overview .....	61
	B. Required Standards.....	63
	C. Ownership.....	66
	D. Period.....	67
	E. Fair Value .....	68
	F. Disclosure .....	71
	G. Competitive Bidding .....	73
	H. Force Majeure.....	76
	I. Profit Sharing.....	78
	J. ESG Considerations.....	79
III.	COMPARISON WITH STOCK SALES.....	81
	A. Overview .....	81
	B. Economics .....	85
	C. Strategy.....	88
	D. Ownership.....	93
	E. Liquidity .....	97
	F. Governance.....	99
	G. Equal Footing .....	101
	H. Regulation for Pricing .....	104
IV.	TOWARD AN EVOLUTION OF FORMATS .....	107
	A. Concessions over Corporatization .....	107
	B. Fund Structure .....	111
	C. Extension to BTO .....	114
V.	CONCLUSION.....	117
	APPENDIX.....	119
	Infrastructure privatization with stock sales, concessions, and corporatization, 2000-2020.....	119

#### I. INTRODUCTION

The objective of the Article is to explore legal architectures for the promotion of private capital investment in infrastructure and to

make the argument that the Japanese government utilizes concessions to navigate the thin line between promoting private investment in infrastructure and protecting the public interest in it. Both advanced and developing countries face a growing need to expand and renew infrastructure in areas such as energy, telecommunications, and transport. However, even advanced economies often lack sufficient funding to meet demand. This is seen as governments address priorities for policy agendas in fields ranging from social and national security to science and education – as well as public health, as made clear by the Covid-19 pandemic. Given the long-term nature of infrastructure, which requires lump-sum outlays before providing long-term benefits, constituents often disagree on the timing of investments. A lack of consensus leads to lagging investment, and meanwhile, people are left with old, often crumbling infrastructure.

Investment in infrastructure is on the rise globally and is predicted to amount to \$78.8 trillion (about 10 quadrillion yen) between 2016 and 2040 in total.<sup>1</sup> Demand for infrastructure investment exceeds this amount by \$14.9 trillion (about 2 quadrillion yen), driven by demand in areas such as electricity and transport in both advanced and emerging economies.<sup>2</sup> Investors in such infrastructure include governments and institutional investors, such as pension funds, that seek long-term assets to meet the needs for pension debt obligations and portfolio diversification.

In Japan, the Government Pension Investment Fund, a public pension fund with world-leading assets of \$1.5 trillion (about 200 trillion yen), became involved in infrastructure investment in 2014 when it committed \$2.5 billion (about 330 billion yen) to a co-investment program with a Canadian pension fund, the Ontario Municipal Employees Retirement System, in infrastructure in Organisation for Economic Co-operation and Development countries.<sup>3</sup> By 2022, the Japanese pension fund had invested \$8 billion (about 1 trillion yen) in infrastructure in the United Kingdom, the United States, Australia, Japan, and continental Europe in fields including renewable energy, airports,

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<sup>1</sup> GLOB. INFRASTRUCTURE HUB, GLOBAL INFRASTRUCTURE OUTLOOK: INFRASTRUCTURE INVESTMENT NEEDS: 50 COUNTRIES, 7 SECTORS TO 2040 25 (2017).

<sup>2</sup> *Id.*

<sup>3</sup> Ontario Municipal Employees Retirement System (OMERS), *OMERS Enters Co-Investment Agreement with Japan's Government Pension Investment Fund and the Development Bank of Japan* (Mar. 3, 2014), <https://www.omersinfrastructure.com/news/omers-enters-co-investment-agreement-with-japans-government-pension/index.html> [<https://perma.cc/2EBE-H4N4>].

seaports, oil and gas pipelines, water supply and sewerage services, and telecommunications.<sup>4</sup>

Introducing private capital is a way to accelerate infrastructure investment while mitigating the burden on public finance. Such investment opportunities, when properly structured, meet the demand of long-term investors such as pension funds. While long-term bonds are also a source of stable cash flow, they are prone to inflation risk in the long term. Infrastructure assets offer a stable cash flow and protection against inflation because cash flows from infrastructure users are adjusted for inflation; people pay more or less for electricity and water bills according to general price levels. However, attracting private capital requires stable legal structures to protect investors, in addition to the overall stability of underlying businesses and predictable cash flows.

Japan has the highest ratio of infrastructure assets to Gross Domestic Product (“GDP”) among the OECD countries and is the only one with a ratio exceeding 100%.<sup>5</sup> The country also has the highest debt-to-GDP ratio of the advanced economies, even with other countries increasing their public deficits in response to the Covid-19 pandemic.<sup>6</sup> The urgent need to renew public infrastructure amid mounting public debt makes it unsustainable for Japan to invest in the same manner as it did in the second half of the twentieth century when the country built most of the public infrastructure that exists today.

In 2011, facing increasing public debt, the Japanese government introduced the concession format by amending the Act on Promotion of Private Finance Initiative (“PFI Act”).<sup>7</sup> A “concession” is defined in the PFI Act as the sale of the operating rights to an infrastructure asset for a specified period, created by the government for specific infrastructure assets under its ownership.<sup>8</sup> While concessionaires, or operators, own the operating rights, the government continues to own

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<sup>4</sup> GOV'T PENSION INV. FUND (GPIF), *Orutanatibu Shisan no Un'yō towa [What is Alternative Asset Management?]*, <https://www.gpif.go.jp/investment/alternative/> [<https://perma.cc/CK57-EYLB>] (last visited Sept. 24, 2022) (Japan).

<sup>5</sup> Jean Marc-Fournier, *The Positive Effect of Public Investment on Potential Growth* 15 (OECD Econ. Dep't, Working Paper No. 1347, 2017).

<sup>6</sup> Marcus Walker & Peter Landers, *Governments World-Wide Gorge on Record Debt, Testing New Limits*, WALL ST. J. (July 12, 2021, 12:16 PM), <https://www.wsj.com/articles/governments-world-wide-gorge-onrecord-debt-testing-new-limits-11626106592?mod=djemCFO> [<https://perma.cc/6CQZ-MWE3>].

<sup>7</sup> Minkan Shikin-tō no Katsuyō ni yoru Kōkyōshisetsu-tō no Seibi-tō no Sokushin ni Kansuru Hōritsu [Act on Promotion of Private Finance Initiative], Law No. 117 of 1999, arts. 16-30 [hereinafter PFI Act] (Japan).

<sup>8</sup> *Id.* at art. 2(6)-(7).

the underlying assets. This combined form of ownership, under which operating rights are owned by the private sector and underlying assets by the public sector, is the basis of a private-public partnership.<sup>9</sup> An “operating right” is defined in the PFI Act as a right in rem,<sup>10</sup> whose effect for the purpose of transactions is to permit that the right is mortgaged for financing and traded with the approval of the government.<sup>11</sup>

Concessions are a different mode of privatization from the outright sale of shares, which was the mainstream format during a wave of privatization in the 1980s and 1990s that saw the Japanese government sell its holdings in major infrastructure companies through initial public offerings (“IPO”). Examples of such sales include the IPOs of Nippon Telephone and Telegraph (“NTT”), and three railway companies. The IPO of NTT in 1987 is still the largest in the country with a valuation of about \$210 billion (about 25 trillion yen) at that time.<sup>12</sup> Those of the three railway companies, Japan Railways (“JR”) East in 1993, JR West in 1996, and JR Central in 1997 resulted from the splitting up of the national railway operator, Japan National Railways (“JNR”), in 1985<sup>13</sup> and had more modest valuations of \$14 billion (1.7 trillion yen), \$6 billion (0.7 trillion yen), and \$7 billion (0.8 trillion yen) respectively. However, in the 2010s, with the wave of IPOs receding, Japan gradually shifted course to utilize concessions, which replaced stock sales as the mainstream format for privatization.

Behind the shift are a series of investments in the 2000s by active investment funds in publicly listed infrastructure companies. In the field of transportation, for instance, a Japanese active fund managed by MAC, an investment firm founded by a former official of the Ministry of Economy, Trade and Industry of Japan, invested in 2005 in Hanshin Electric Railway Co., a railway company based in Osaka and

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<sup>9</sup> CABINET OFF. OF JAPAN, PPP/PFI SUISHIN GAIDORAIN REIWA 4-NEN KAITEIBAN [PPP/PFI PROMOTION GUIDELINE, 2022 REVISED ED.] (2022), [https://www8.cao.go.jp/pfi/actionplan/pdf/actionplan\\_r4\\_2.pdf](https://www8.cao.go.jp/pfi/actionplan/pdf/actionplan_r4_2.pdf) [<https://perma.cc/RP7K-DZ4J>].

<sup>10</sup> *Id.* at art. 24.

<sup>11</sup> *Id.* at art. 25.

<sup>12</sup> *History*, NIPPON TEL. & TEL. CORP., <https://group.ntt/en/ir/shares/history.html> [<https://perma.cc/B2WQ-NALP>] (Jan. 6, 2022).

<sup>13</sup> *JR Tōkai Kabushiki no Baikyaku Jōjō* (9. 10. 8) [*Sale and Listing of JR Tokai Shares* (Oct. 8, 1997)], MINISTRY OF TRANSP. OF JAPAN, UN’YU HAKUSHO, HEISEI 9 NENDO [WHITE PAPER ON TRANSPORT, FISCAL YEAR 1997] (1997), <https://www.mlit.go.jp/hakusyo/transport/heisei09/topic/17.html> [<https://perma.cc/8B46-4M6Q>] (Japan); *see also infra* Part III(A).

the owner of a namesake professional baseball team.<sup>14</sup> The fund accumulated holdings of 52% by 2006 and demanded board seats and a spinoff of the baseball team subsidiary.<sup>15</sup> The company resorted to calling upon its regional competitor, Hankyu Co., as a white knight, and a merger of the two led to the fund's unwinding of the investment.<sup>16</sup>

Similarly, in 2007 an investment fund managed by Australia's Macquarie Group invested in Japan Airport Terminal Co., owner and operator of the airport terminal building at Haneda Airport, the largest airport in the country and the fourth largest in the world.<sup>17</sup> The airport terminal building company listed its shares in 1990 amid a wave of public listings of infrastructure promoted by the Japanese government.<sup>18</sup> The Macquarie fund invested with the aim of holding 19.9% of the company's shares, but it ended up selling all of its holdings back to the company through a tender offer ("TOB") process conducted two years later by the company itself,<sup>19</sup> presumably because it found little promise in engaging with the investee's management. After observing the face-off at the airport terminal building company, the government suspended a planned sale of stocks in Narita International Airport Co., the operator of the country's second-largest airport after Haneda.<sup>20</sup> The suspension occurred despite the fact that the company converted

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<sup>14</sup> *Hankyūhanshin Tōgō 10-nen Kenshō (Jō)* [A Review of the Decade Following the Merger of Hankyu and Hanshin (I)], SANKEI SHIMBUN [SANKEI NEWSPAPER] (Sept. 29, 2016, 5:00 AM), <https://www.sankei.com/article/20160929-W7AMYNLJWVPXHLLIBR6US7WYIY/> [<https://perma.cc/RG63-PLHW>] (Japan).

<sup>15</sup> *Id.*; Hidetaka Kawakita & Rei Miyano, *Investment Behavior and the Role of the Murakami Fund*, 45 NISSAY KISOKEN SHOHO 4-5 (2007), [https://www.nli-research.co.jp/files/topics/37019\\_ext\\_18\\_0.pdf](https://www.nli-research.co.jp/files/topics/37019_ext_18_0.pdf) [<https://perma.cc/5FG4-7GLZ>] (Japan).

<sup>16</sup> SANKEI SHIMBUN, *supra* note 14.

<sup>17</sup> AIRPORTS COUNCIL INT'L, *ACI Reveals Top 20 Airports for Passenger Traffic, Cargo, and Aircraft Movements* (May 19, 2020), <https://aci.aero/2020/05/19/aci-reveals-top-20-airports-for-passenger-traffic-cargo-and-aircraft-movements/> [<https://perma.cc/L5Q3-TCB2>].

<sup>18</sup> *Company History*, JAPAN AIRPORT TERMINAL CORP., [https://www.tokyo-airport-bldg.co.jp/en/corporate\\_profile/history/history.html](https://www.tokyo-airport-bldg.co.jp/en/corporate_profile/history/history.html) [<https://perma.cc/8TBR-EQ89>] (last visited Nov. 6, 2022).

<sup>19</sup> Akihito Fukuda, *Ōsutoraria Makkōrī: Nikku Biru Tōshi no Tettai Kanryō, Hoyū Zenshu o TOB de Baikyaku* [Macquarie Withdraws from Japan Airport Terminal, Selling its Holdings by TOB], BLOOMBERG (July 29, 2009, 1:36 PM), <https://www.bloomberg.co.jp/news/articles/2009-07-29/KNJ0T10UQVI901> [<https://perma.cc/G229-XGHL>] (Japan).

<sup>20</sup> AIRPORTS COUNCIL INT'L, *supra* note 17.

from a government agency to a corporation wholly owned by the government three years earlier in preparation for the sale of all its stock.<sup>21</sup>

In the field of energy, The Children's Investment ("TCI") fund in the U.K. invested in J-Power Co., a wholesale power producer, in 2007, holding 9.9% of its shares.<sup>22</sup> The energy company, founded in 1952 with 66.7% ownership by the government and the remainder by major electricity power companies, was listed three years before the TCI's investment.<sup>23</sup> Faced with the investment, the Japanese government issued its first rejection of the fund's request to approve an increase in its holdings to up to 20% of the shares.<sup>24</sup> The request and rejection processes were based on the Foreign Exchange and Foreign Trade Act ("FEFTA") at the time, which required government approval of cross-border investments in pre-specified key industries holding 10% or more of the shares of investee companies.<sup>25</sup> Following the rejection, the fund unwound the investment and sold its entire holdings back to the company a year later.<sup>26</sup> FEFTA was amended in 2019 to lower the threshold to 1%, with exemptions applied to passive

<sup>21</sup> *Japan to Privatize Narita Airport by '04*, WALL ST. J. (Oct. 11, 2002, 1:00 AM), <https://www.wsj.com/articles/SB1034220275725039036> [<https://perma.cc/54WK-MDPS>]; Dai 156-kai Kokkai Kokudo Kōtsū Iinkai Dai 22-gō (Heisei 15-nen 5-gatsu 20-nichi (kayōbi)) [*Minutes of the 20th Session of the Committee on Land, Infrastructure, Transport and Tourism, 156th Ordinary Session of the Diet*], HOUSE OF REPRESENTATIVES OF JAPAN (May 20, 2003), [https://www.shugiin.go.jp/inter-net/itdb\\_kaigirokua.nsf/html/kaigirokua/009915620030520022.htm#TopContents](https://www.shugiin.go.jp/inter-net/itdb_kaigirokua.nsf/html/kaigirokua/009915620030520022.htm#TopContents) [<https://perma.cc/3LE8-N9FA>] (Japan).

<sup>22</sup> Yoshihiro Shimoi, *Hajimete Hajimete Hatsudō Sareta Gaitamehō ni Motozuku Chūshi Meirei ~ TCI Fando ni Yoru J-Pawā Kabushiki no Tsuika Shutoku no Jirei ni Tsuite* [*First Suspension Order Issued Based on the Foreign Exchange Act – Case of Additional Acquisition of J-Power's Shares by TCI Fund*], FIN. 22 (Dec. 2008), [https://dl.ndl.go.jp/view/download/digidepo\\_1006427\\_po\\_f2012e.pdf?contentNo=1&itemId=info:ndljp/pid/1006427&\\_lang=en](https://dl.ndl.go.jp/view/download/digidepo_1006427_po_f2012e.pdf?contentNo=1&itemId=info:ndljp/pid/1006427&_lang=en) [<https://perma.cc/W975-WQLH>] (Japan).

<sup>23</sup> MINISTRY OF ECON., TRADE & INDUS., *Dengen Kaihatsu no Min'eika ni Tsuite* [*On Privatization of J-Power*] (Feb. 2003), <https://www.gyokaku.go.jp/sanyo/dai10/10siryou2.pdf> [<https://perma.cc/7Y58-DTPK>] (Japan).

<sup>24</sup> Shimoi, *supra* note 22.

<sup>25</sup> Gaikoku Kawase oyobi Gaikoku Bōekihō [Foreign Exchange and Foreign Trade Act], Law No. 228 of 1949, art. 27(5) (Japan).

<sup>26</sup> Reiji Murai & Kentaro Hamada, *J-Pawā ga Ei TCI Kara Jisha Kabu o Kaitori e, 9.9-Pāsento o Sōgaku 631 Oku-en de* [*J-Power to Buy Back Its Own Shares from UK TCI, 9.9% for a Total of 63.1 Billion Yen*], REUTERS (Oct. 31, 2008, 8:05 AM), <https://jp.reuters.com/article/idJPJAPAN-34677920081031> [<https://perma.cc/FW8R-HD58>] (Japan).

investors,<sup>27</sup> following similar amendments in the United States in 2018 with no threshold, in Germany in 2018 with a 10% threshold, and in the U.K. in 2021 and France in 2019 with a 25% threshold.<sup>28</sup>

Pressed with mounting public debt, Japan is caught in a double bind between the need to regulate cross-border investments in core infrastructure and to secure financing for those long-term assets. The Article argues that the concession format provides an answer by allowing deals to be structured in line with the market for privatizing infrastructure while addressing public concerns that arose at the time of the activist funds' investments. The format has been successful in attracting private capital, from both outside and inside the country, without any major public backlash. Airport privatization has been at the vanguard of the trend. The privatization of Osaka's Kansai Airport, the country's third largest after Haneda and Narita, attracted capital from a French operator, Vinci, in a partnership with a Japanese local operator, Orix.<sup>29</sup> Fukuoka Airport, the country's fourth largest, received investment from Changi Airport Group, a Singaporean airport operator, along with other local partners including Nishi-Nippon Railroad Co.<sup>30</sup> Proceeds obtained from selling the operating rights to these facilities have served to reduce the government's public debt, as have cost savings on their future maintenance and expansion, the responsibilities for which are undertaken by the concessionaires.<sup>31</sup>

Having opened the way with airports, the country expanded the areas for concessions in the 2010s to include highways, hydropower stations, educational facilities, stadiums, public housing, water supply

<sup>27</sup> See *infra* Part III(D).

<sup>28</sup> MINISTRY OF FIN. OF JAPAN, Gaikoku Kawase oyobi Gaikoku Bōekihō no Ichibu o Kaisei Suru Hōritsu-an ni Tsuite Reiwa gan-nen 10-gatsu 25-nichi Kaitei [ON THE AMENDMENT TO THE FOREIGN EXCHANGE AND FOREIGN TRADE ACT] 9 (2019) (Japan); MINISTRY OF INTERNAL AFFS. & COMMC'NS, JŌHŌ TSŪSHIN BUN'YA NI OKERU GAISHI KISEI NO GENJŌ [THE CURRENT STATUS OF REGULATIONS ON FOREIGN DIRECT INVESTMENT] 51 (2021) (Japan).

<sup>29</sup> *Orix Bets on Infrastructure Business for Growth*, NIKKEI ASIA (Feb. 18, 2017, 12:05 PM), <https://asia.nikkei.com/Business/Finance/Orix-bets-on-infrastructure-business-for-growth> [<https://perma.cc/HF9M-NYWK>].

<sup>30</sup> Nia Tam, *Japan Awards 30-Year Concession for Fukuoka Airport*, INFRASTRUCTURE INV. (June 27, 2018), <https://www.infrastructureinvestor.com/japan-awards-30-year-concession-fukuoka-airport/> [<https://perma.cc/KLW3-89WV>].

<sup>31</sup> CABINET OFF. OF JAPAN, KAKUGI-KETTEI MINKAN SHIKIN-TŌ NO KATSUYŌ NI YORU KŌKYŌSHISETSU-TŌ NO SEIBI-TŌ NI KANSURU JIGYŌ NO JISSHI NI KANSURU KIHON-HŌSHIN [CABINET DECISION ON PRINCIPLES ON THE IMPLEMENTATION OF PRIVATE FINANCE INITIATIVE] (Oct. 23, 2018), [https://www8.cao.go.jp/pfi/hourei/kaisei/pdf/h30kaisei\\_kihonhoushin.pdf](https://www8.cao.go.jp/pfi/hourei/kaisei/pdf/h30kaisei_kihonhoushin.pdf) [<https://perma.cc/MN7Z-GDH6>].



and sewage services, and convention centers, accomplishing this through amendments to the Act on Promotion of Private Finance Initiative.<sup>32</sup> Table 1 categorizes the number of infrastructure privatizations by format, stock sales, concessions, and corporatization (conversion into corporation) between 2000 and 2021.<sup>33</sup> A complete list of privatized infrastructure is provided in Appendix A.

**Table 1.** Number of infrastructure privatizations by format, 2000-2021

Sector \ Format	Stock sales	Concessions	Corporatization
Energy	1	2	-
Transportation			
Airport	-	12	1
Seaport	-	-	2
Railway	1	-	2
Road		1	4
Postal service	1	-	-
Banking/Insurance	2	-	3
Water and sewage	-	3	-
Convention center	-	2	-
Sport facility and others	-	6	-
Total	5	30	12

Note: The table shows only projects that were concluded and does not include infrastructure for which a privatization plan has only been announced. The counts are mutually exclusive.

The table reveals that concessions are used far more than stock sales. There were only five stock sales during the period: J-Power, JR Kyushu, Japan Post Holdings, and Japan Post Holdings' two subsidiaries.<sup>34</sup> The table also shows that airports constitute the largest category of privatizations, followed by facilities such as art museums, sports facilities, and water supply and sewage services.

<sup>32</sup> PFI Act, *supra* 7, at art. 2(1)(iii)(v).

<sup>33</sup> CABINET OFF. OF JAPAN, KŌKYŌ SHISETSU-TŌ UN'EI JIGYŌ NO OMONA SHINCHOKU JŌKYŌ [ON THE PROGRESS OF CONCESSIONS] (Apr. 9, 2020), <https://www8.cao.go.jp/pfi/concession/pdf/concession.pdf> [<https://perma.cc/RNL3-NT9B>] (Japan).

<sup>34</sup> See Table 1 and Appendix.

Among these, Kansai Airport, which is counted as one of the concessions, is the only example of a hybrid format combining corporatization and concession.<sup>35</sup> In this case, the government-owned Osaka International (Itami) Airport merged into a corporation that owns and operates Kansai International Airport (corporatization). The corporation's stocks were wholly owned by the government. The merged company then sold the operating rights to the entire company, while the government maintained full ownership of the stock (concession).<sup>36</sup> It is noteworthy that the privatization was made not through stock sales of the merged company, which would have been a traditional step after corporatization, but through concession. Under this structure, the merged airport company, not the government, concluded a concession contract with an operator, a Franco-Japanese joint venture by Vinci and Orix.<sup>37</sup> Whereas a common concession format would have the government and an operator conclude a concession contract for an infrastructure asset owned by the government.<sup>38</sup> Subsequent to Kansai Airport's privatization through concession, Kobe Airport, on the outskirts of that city, was also privatized through concession, with the Kobe City government holding the airport assets and selling its operating rights.<sup>39</sup> The operator of Kansai Airport won these rights through its wholly owned subsidiary, essentially bundling the three airports, Kansai International, Itami, and Kobe under one private umbrella.<sup>40</sup> This case also shows that corporations whose shares are

<sup>35</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KANSAIKOKUSAİKŪKŌ OYABI ITAMIKŪKŌ NO ITTAI-TEKI OYABI KORITSU-TEKI NA SECCHI OYABI KANRI NI KANSURU KIHON-HOSHIN [PRINCIPLES ON THE INTEGRATED AND EFFICIENT OPERATION OF KANSAI INTERNATIONAL AIRPORT AND OSAKA INTERNATIONAL AIRPORT] (2012), <https://www.mlit.go.jp/common/000214479.pdf> [<https://perma.cc/W8RB-VXJX>] (Japan).

<sup>36</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KANSAIKOKUSAİKŪKŌ ITAMIKŪKŌ NO KEIEI TŌGŌ NI TSUITE [ON THE INTEGRATION OF KANSAI INTERNATIONAL AIRPORT AND ITAMI AIRPORT] (2012), <https://www.mlit.go.jp/common/000218477.pdf> [<https://perma.cc/RZ7G-4UEP>] (Japan); Kansaikokusaikūkō oyobi Ōsakakokusaikūkō no Ittai-teki katsu Kōritsuteki na Un'ei ni Kansuru Hōritsu [Act on the Integrated and Efficient Operation of Kansai International Airport and Osaka International Airport], Law No. 54 of 2011, arts. 1, 9, 10 (Japan).

<sup>37</sup> *Id.*

<sup>38</sup> PFI Act, *supra* note 7, at arts. 2(1), (6).

<sup>39</sup> KOBE CITY, KŌBEKŪKŌ NO KONSESSHON NI TSUITE [ON THE CONCESSION OF KOBE AIRPORT], <https://www.city.kobe.lg.jp/a11380/kurashi/access/airport/archives/08/index.html> [<https://perma.cc/YH8R-2LQP>] (Japan) (Aug. 20, 2021).

<sup>40</sup> *Kōbekūkō 18-nen 4-gatsu ni Min'eika Shi to Orikkusu Jin'ei ga Keiyaku [Kobe Airport to be Privatized in April 2018: Contract Signed by City and Orix Consortium]*, NIKKEI (Sept. 26, 2017, 4:16 PM),

owned by the government can still be privatized through concessions.<sup>41</sup>

Based on the rapid adoption of concessions after the airport examples, the Article analyzes the format's contractual structures and regulatory design, makes comparisons with stock sales, and discusses agendas for the further development of infrastructure privatization and the attraction of private capital for that purpose. This should serve as an analytical framework for infrastructure investment through privatization and contribute to the discussion of how best to secure public interest in infrastructure. It examines how matters such as national security, resilience to natural disasters, and user safety and utility interact with the promotion of private investment.

The remainder of the Article is constructed as follows. Part II analyzes the contractual and regulatory structures of infrastructure concessions based on some leading examples. Part III compares concessions and stock sales as formats for privatization. Part IV discusses agendas for the development of a contractual and regulatory design. Part V concludes the Article.

## II. STRUCTURE OF CONCESSIONS

This section analyzes the major contractual and regulatory structures for concessions adopted in Japanese infrastructure. Since airports are the prime example in terms of case numbers, their success has meant that their practices have become standard in subsequent concession projects. Therefore, most arrangements draw from airport projects unless otherwise noted.

### A. Overview

While private finance initiatives (“PFI”) have been used to outsource works in the public domain, such as the construction and operation of public infrastructure at the cost and risk of the government,<sup>42</sup> concessions are a new and significantly different format in that the private sector undertakes the financial risks and rewards of the existing infrastructure assets while the government maintains ownership of the underlying assets.<sup>43</sup> The private sector obtains the full right to receive

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[https://www.nikkei.com/article/DGXLASJB26H3Q\\_W7A920C1000000/](https://www.nikkei.com/article/DGXLASJB26H3Q_W7A920C1000000/)  
[<https://perma.cc/AFF3-5MSH>] (Japan).

<sup>41</sup> See *infra* Part IV(A).

<sup>42</sup> PFI Act, *supra* note 7, at arts. 2(2), 5.

<sup>43</sup> *Id.* at art. 2(6).

cash flows generated from the assets' operation, with discretion over the pricing of fares and charges, along with the responsibility to make investments for the assets' maintenance.<sup>44</sup> The term of operation for an infrastructure asset ("operating period") is not stipulated in the PFI Act, but the principles published by the government and specifically applied to airports prespecified a term of between thirty to fifty years,<sup>45</sup> during which time the concessionaires recover their investments.

The government solicits competitive bids for the sale of operating rights.<sup>46</sup> Bidders are required to submit legally binding proposals for various aspects of operation, including investment, financing, and governance of the infrastructure during the operating period, as well as the bidding price for the operating right.<sup>47</sup> Proposals are typically made by a consortium of companies with different skill sets.<sup>48</sup> The payment for the right can be a lump-sum payment upfront or annual payments, depending on the design of the terms and conditions for individual deals.<sup>49</sup> A government-appointed committee reviews the proposals and makes a recommendation to the government.<sup>50</sup> Both quantitative aspects, such as the bidding price for the right and committed capital investments, and qualitative ones, such as operating and marketing plans for the period, are evaluated and given numerical grades.<sup>51</sup> The Minister of Land, Infrastructure, Transport and Tourism, who is the Minister in charge, makes a final decision based on the recommendation.<sup>52</sup>

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<sup>44</sup> *Id.*

<sup>45</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, MINKAN NO NORYOKU O KATSUYO SHITA KUNI-KANRI KUKO-TO NO UN'EI-TO NI KANSURU KIHON-HOSHIN [PUBLIC NOTICE ON THE PRINCIPLES OF AIRPORT CONCESSIONS UTILIZING PRIVATE CAPABILITY] II-2 (2013) [hereinafter PRINCIPLES], <https://www.mlit.go.jp/common/001018628.pdf> [<https://perma.cc/G34Y-BCXE>] (Japan).

<sup>46</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KUKO TOKUTEI UN'EI JIGYO-TO JISSHI HOSHIN [IMPLEMENTATION POLICY ON THE CONCESSION OF SENDAI AIRPORT] III-1 (2014) [hereinafter IMPLEMENTATION POLICY], <https://www.mlit.go.jp/common/001037649.pdf> [<https://perma.cc/8P6U-VFRD>] (Japan).

<sup>47</sup> *Id.* at II-1-8, 13, 16.

<sup>48</sup> *Id.* at III-3-1.

<sup>49</sup> *Id.* at II-1-16.

<sup>50</sup> *Id.* at III-2-1.

<sup>51</sup> *Id.* at III-2; MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KUKO TOKUTEI UN'EI JIGYO-TO SHINSA KOHYO [THE EVALUATION OF THE PROPOSALS FOR THE CONCESSION OF SENDAI AIRPORT] 2(1), 2(2) (2015), <https://www.mlit.go.jp/common/001106922.pdf> [<https://perma.cc/9FC3-FUXW>] (Japan).

<sup>52</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-2-6.

The selected consortium establishes a special purpose vehicle (“SPV”) to purchase the operating right from the government, financing it with an equity investment by the consortium members and bank borrowings backed by the right.<sup>53</sup> An SPV is used because of a rule that prohibits the holder of the operating right from working on projects other than the operation of the specified infrastructure.<sup>54</sup> The rule requires that it be bankruptcy-remote from the possible failure of other projects that the sponsors of the SPV might undertake.<sup>55</sup> If the concessionaire defaults on its obligations, the government can terminate the contract and recover control of the infrastructure asset while claiming damages relating to the default from the concessionaire.<sup>56</sup>

Concessions are different from stock sales in several ways.<sup>57</sup> While stock sales involve the permanent transfer of ownership in its entirety, concessions transfer operating rights only for a finite period.<sup>58</sup> In addition, concessionaires are restricted from making investments outside the specified infrastructure, while companies privatized through stock sales typically are not.<sup>59</sup> The latter is expected to explore new markets and build new capabilities for growth.<sup>60</sup> While stock sales are executed in the capital markets through IPO for general investors, concessions are executed through a competitive bidding process to select a specific concessionaire, although the process itself is open to all candidates both in and out of the country.<sup>61</sup> The differences between the two formats are further analyzed in Part III.

### B. Required Standards

The public nature of infrastructure gives rise to both positive and negative externalities. While infrastructure provides functions that users can benefit from with minimal or no marginal costs (positive externalities), it also causes undesirable effects that both users and non-

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<sup>53</sup> *Id.* at III-2-9.

<sup>54</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KŪKŌ TOKUTEI UN’EI JIGYŌ-TŌ KŌKYŌ SHISETSU-TŌ UN’EI-KEN JISSHI KEIYAKUSHO [CONCESSION CONTRACT FOR SENDAI AIRPORT] art. 26 (2015) [hereinafter CONTRACT], <https://www.mlit.go.jp/common/001111789.pdf> [<https://perma.cc/QP76-HAVU>] (Japan).

<sup>55</sup> *Id.* at art. 56.

<sup>56</sup> *Id.* at art. 68.

<sup>57</sup> *See infra* Part III.

<sup>58</sup> *Id.* at (D).

<sup>59</sup> *Id.* at (C).

<sup>60</sup> *Id.* at (A), (D).

<sup>61</sup> *Id.*

users must come to terms with (negative externalities).<sup>62</sup> These aspects are mirrored in the contractual and regulatory design of concessions that stipulate minimum standards for the functions an infrastructure asset is expected to provide, while also stipulating maximum standards for the negative effects it can produce – such as emissions, noises, vibration, and other byproducts.<sup>63</sup> These constitute the required standards to which concessionaires must agree upon the transfer of an operating right. They include both quantitative and qualitative specifications. When qualitative standards are set in the form of language, as opposed to numerical metrics, uncertainty can arise regarding the interpretation of such language. However, this does not create much of a problem for concessions because infrastructure assets chosen for concessions tend to be established kinds, such as airports and toll roads, which have a track record of operations and practices.<sup>64</sup> Operators can look at similar assets for reference, thus providing predictable levels of quality.

Because concessionaires are likely to face a trade-off between quality and cost, and thus financial return, these standards give them clarity as to how much they need to invest. When operating an infrastructure asset, a concessionaire may have incentives to cut back on investing in, for example, the replacement of equipment or pollution mitigation, in order to obtain an improved return. Indeed, empirical evidence shows that managers reduce investments to meet earnings targets.<sup>65</sup> The required standards, either maximum or minimum, form a basis for the expectations of the government and the concessionaire, and thus for the latter's investment budgets estimated at the time of bidding.<sup>66</sup> Investment budgets for maintenance are essentially a slice of a pie that concessionaires share with the government by operating the infrastructure asset, as the government saves that amount in addition to receiving payment for the operating right.

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<sup>62</sup> ARNO SCHROTEN, HUIB VAN ESSEN, LISANNE VAN WIJNGAARDEN, DANIEL SUTTER, & ELLA ANDREW, SUSTAINABLE TRANSPORT INFRASTRUCTURE CHARGING AND INTERNALISATION OF TRANSPORT EXTERNALITIES: EXECUTIVE SUMMARY (2019), <https://data.europa.eu/doi/10.2832/246834> [<https://perma.cc/T8R2-4HY7>].

<sup>63</sup> PRINCIPLES, *supra* note 45, at II-3.

<sup>64</sup> ORG. FOR ECON. COOP. & DEV. (OECD), POOLING OF INSTITUTIONAL INVESTORS CAPITAL – SELECTED CASE STUDIES IN UNLISTED EQUITY INFRASTRUCTURE, 10, 26 (Apr. 2014), <https://www.oecd.org/finance/OECD-Pooling-Institutional-Investors-Capital-Unlisted-Equity-Infrastructure.pdf> [<https://perma.cc/9L7Z-B4C2>].

<sup>65</sup> John R. Graham, Campbell R. Harvey & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 32, 39 (2005).

<sup>66</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1-11.

Maximum standards typically do not include specific limits on pricing, except in reference to laws applied in general to the infrastructure of specific categories. In the case of airports, maximum charges are not stipulated in the required standards, nor are individual price lists subject to approval by the government.<sup>67</sup> They are, however, subject to a law that prohibits unfair and discriminatory pricing for particular users, as well as markedly inappropriate pricing that would make the infrastructure extremely difficult to use in light of social or economic conditions.<sup>68</sup> Past examples illustrate this flexibility. An airport concessionaire at Sendai introduced a risk-sharing pricing scheme that involved lowering a fixed portion of the charge for airliners while increasing a variable portion so that low demand would lead to lower charges and vice versa.<sup>69</sup> The result was an increase in the number of routes and passengers thanks to better risk-sharing between airliners and the airport concessionaire.<sup>70</sup> Other examples are discounts offered to deal with early-phase uncertainty during the first few years after the opening of new routes, or for the addition of routes in and out of the airport.<sup>71</sup> Such flexibility in pricing for the purpose of increasing demand is one of the advantages of concessions. Concessionaires tailor their strategies to the needs of individual assets, while the government may be restrained from taking similar initiatives by needing to emphasize equality among its airports and having little economic incentive to increase traffic.

During the operating period, the government monitors concessionaires to check that they meet the required standards and are implementing their operating proposals, which are legally binding. If it finds a breach of those requirements, the government can order the concessionaire to fix it, or proceed to terminate the concession contract after a cure period normally lasting 120 days.<sup>72</sup> Such monitoring is not new for the government, since it performs the dual role of operator and regulator for the infrastructure assets it operates itself. When a

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<sup>67</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1-8.

<sup>68</sup> Kūkō Hō [Airport Act], Law No. 80 of 1956, art. 13(2)(i)(ii) (Japan).

<sup>69</sup> SENDAI INT'L AIRPORT CO., SENDAI KŪKŌ NO 30-NEN-GO NO SHŌRAI IMĒJI <MASUTĀPURAN> [MASTER PLAN FOR SENDAI AIRPORT] 2 (2016), <https://www.sendai-airport.co.jp/pdf/master-plan.pdf> [<https://perma.cc/DZ2U-46PU>] (Japan).

<sup>70</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KŪKŌ NO UN'EI ITAKU NI YORU SEIKA [RESULTS OF THE CONCESSION OF SENDAI AIRPORT], <https://www.mlit.go.jp/common/001231163.pdf> [<https://perma.cc/9B8U-2ECC>] (Japan).

<sup>71</sup> SENDAI INT'L AIRPORT CO. *supra* note 69.

<sup>72</sup> CONTRACT, *supra* note 54, at art. 52.

concession is arranged, the government focuses on the latter role based on its contract with the concessionaire.

### C. Ownership

The main reason that the Japanese government retains ownership of underlying infrastructure assets throughout a concession is its success in gathering public support for privatizing infrastructure, despite the economic rights that generally derive from ownership being transferred to contracted concessionaires. However, this is not just for appearance because ownership of the underlying assets gives the government bargaining power, even if the same economic position could be created through a contract.<sup>73</sup> Although a contractual breach may be cured through court proceedings,<sup>74</sup> enforcement of a contract without ownership would involve greater uncertainty and thus costs. Ownership of the underlying assets allows the government to restore its original status by unwinding the contract,<sup>75</sup> which it could not achieve through stock sales as it would lack both ownership and a continued contractual relationship.

The government's ownership also relates to the issue of control in the event of a natural disaster or other extraordinary events – not a hypothetical consideration but a real need in a country that regularly experiences earthquakes, typhoons, landslides, and heavy rains. In such situations, the government may order concessionaires to cooperate with public authorities in urgent responses to such events with proper compensation for lost profits.<sup>76</sup> A case in point is Sendai Airport in Japan's northeastern region, nearest to the epicenter of the Great East Japan Earthquake of 2011.<sup>77</sup> People caught in the terminal building at the time of the earthquake survived by eating food from the shelves of retail outlets that the airport operator bought; the building's operator offered the food for free while working to get the airport

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<sup>73</sup> Albert H. Choi & George G. Triantis, *The Effect of Bargaining Power on Contract Design*, 98 VA. L. REV. 1665, 1702-10 (2012).

<sup>74</sup> CONTRACT, *supra* note 54, at art. 94.

<sup>75</sup> *Id.* at art. 77.

<sup>76</sup> PFI Act, *supra* note 7, at art. 29; PRINCIPLES, *supra* note 45, at III-2(2); CONTRACT, *supra* note 54, at art. 53.

<sup>77</sup> COMM. ON CONSTR. MGMT., JAPAN SOC'Y OF CIV. ENG'RS, KOTŌ TO KASHITA KŪKŌ BIRU HINAN-SHA NO ANZEN KAKUHO - SENDAI KŪKŌ TAMINARUBIRU SHACHŌ NO KŌDŌ [SAFETY MEASURES FOR EVACUEES LEFT ISOLATED AT THE SENDAI AIRPORT BUILDING] (2014), [https://committees.jsce.or.jp/s\\_research/system/files/25.2-8.pdf](https://committees.jsce.or.jp/s_research/system/files/25.2-8.pdf) [<https://perma.cc/WRE8-VFKC>] (Japan).



up and running again for the transport of relief goods and personnel.<sup>78</sup> The airport resumed operation five days after the earthquake and served as a hub for the movement of emergency relief goods and rescue personnel to devastated areas.<sup>79</sup> Four years later, Sendai Airport became the first example of an airport concession directly owned by the central government with a stipulation to provide emergency responses.<sup>80</sup> The concession was won by a consortium led by Tokyu Co., a domestic railway and real estate operator.<sup>81</sup>

#### D. Period

The operating period is prespecified by the government between thirty and fifty years.<sup>82</sup> The setting of a finite period is a hallmark of concessions, distinguishing the format from stock sales and producing different incentives.<sup>83</sup> It may come with an extension option, which the operator can exercise under prespecified conditions.<sup>84</sup> Even before the end of the operating period, the government can terminate a contract if certain events occur that are stipulated in the contract, such as failure by a concessionaire to satisfy the required standards even after the cure period.<sup>85</sup> Compared with an outright sale of stock, such a termination means that the government maintains stronger control over the infrastructure assets as a monitor and party to the contract.<sup>86</sup>

To a concessionaire, a finite period also implies that it will commit to the contract for the duration of the period. Although an exit from investment during the operating period is possible (with the approval of the government) through the sale of stakes in the SPV that owns the operating right, such approval requires continuity of operation before

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KŪKŌ TOKUTEI UN'EI JIGYŌ-TŌ NO YŪSEN KŌSHŌ-KEN-SHA NO SENTEI NI TSUITE [ON THE SELECTION OF THE PREFERRED NEGOTIATION PARTY FOR THE CONCESSION OF SENDAI AIRPORT] (2015), <https://www.mlit.go.jp/common/001103817.pdf> [<https://perma.cc/JD5L-WDCR>] (Japan).

<sup>81</sup> *Id.*

<sup>82</sup> PRINCIPLES, *supra* note 45, at II-2.

<sup>83</sup> *Id.*

<sup>84</sup> CONTRACT, *supra* note 54, at art. 62(1)(ii).

<sup>85</sup> *Id.* at art. 52(4).

<sup>86</sup> CABINET OFF. OF JAPAN, KŌKYŌ SHISETSU-TŌ UN'EI-KEN OYOBI KŌKYŌ SHISETSU-TŌ UN'EI JIGYO NI KANSURU GAIDORAIN [GUIDELINES ON THE RIGHT TO OPERATE THE PUBLIC FACILITY, ETC. AND THE PUBLIC FACILITY, ETC. OPERATING PROJECT] 47 (2021), [https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken\\_guideline.pdf](https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken_guideline.pdf) [<https://perma.cc/V9NR-3QUR>] (Japan).

and after the sale.<sup>87</sup> This requirement may undermine the liquidity of an investment, especially at an early phase of operation<sup>88</sup> However, in practice concessionaires are unwilling to divest at this point because this is precisely the phase at which they typically make capital investments, the effects of which appear later in the period for improved valuation.

### E. *Fair Value*

Given that the privatization of infrastructure is a trade between the government and a private concessionaire, rules concerning fair value are key to transparency and predictability. A fundamental approach is for the fair value of the operating right to be decided in the open market through competitive bidding, the fair value being the present value of future cash inflows derived from operating an infrastructure asset minus the present value of future cash outflows made to maintain the asset.<sup>89</sup>

In addition to operating rights, some assets are traded at the beginning and the end of the operating period.<sup>90</sup> With most airport concessions, all stock in the company which owns the airport terminal building is sold to the concessionaire, rather than an operating right being created on the building.<sup>91</sup> This practice means that the company's workforce is taken over by the concessionaire.<sup>92</sup> It is done because the stock in the terminal building company is not owned by the government, unlike the runways and lands underlying them.<sup>93</sup> The stock is typically owned by private companies such as local businesses and airline carriers, as well as municipal governments where the airport is located.<sup>94</sup> Other ancillary assets owned by the government, such as vehicles used within the site and in-house power generators, are also

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<sup>87</sup> IMPLEMENTATION POLICY, *supra* note 46, at IV-4-2.

<sup>88</sup> *See infra* Part III(E).

<sup>89</sup> RICHARD A. BREALEY, STEWART C. MYERS, FRANKLIN ALLEN & ALEX EDMANS, PRINCIPLES OF CORPORATE FINANCE 159 (14th ed. 2022).

<sup>90</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1-7 (B).

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-2-13.

<sup>94</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KONSESSHON-TŌ NI KANSURU WĀKINGU GURŪPU (DAI 1-KAI) SETSUMEI SHIRYŌ [MATERIAL FOR THE WORKING GROUP ON CONCESSIONS] 3 (Feb. 21, 2022), [https://www.cas.go.jp/jp/seisaku/atarashii\\_sihonsyugi/wgkaisai/concession\\_dai1/siryou2.pdf](https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugi/wgkaisai/concession_dai1/siryou2.pdf) [<https://perma.cc/64LU-LCQN>].

sold to the concessionaire because they are too short-lived to merit the creation of an operating right.<sup>95</sup>

The selling of terminal building companies ties in with the development trajectory of Japanese airports. When the Japanese government started reconstructing transportation infrastructure after the country's defeat in World War II ("WWII"), it dealt with a chronic lack of capital by letting private businesses create corporations to build, own, and operate the land-side terminal buildings, which produced profits through commercial operations such as retail outlets and restaurants.<sup>96</sup> Meanwhile, the government spent its scarce capital on the air-side runways, which were relatively unprofitable or even loss-making.<sup>97</sup> Because of this path-dependent mode of development, the government would acquire an interest in land-side commercial building companies prior to a concession, with the aim of integrating them with air-side operations.<sup>98</sup> From this perspective, Japanese airport concessions have an added policy implication of integrating the air and land sides of an airport.<sup>99</sup>

Thus, the government negotiates contracts with all shareholders of the corporation that owns and operates an airport terminal building for the right to purchase all their holdings.<sup>100</sup> By doing so, the government packages ownership of air- and land-side assets, for competitive bids along with the operating rights for airside runways.<sup>101</sup> The contract, typically with representations and warranties, stipulates a fixed purchase price.<sup>102</sup> This means that any changes between the signing and the final closing, which takes place several months or even over a year after the signing, will not be reflected in the price unless all parties agree to the change. The government transfers the contract to the winning bidder, which exercises the right to purchase the shares from the original shareholders.<sup>103</sup> In this way, the government transfers

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<sup>95</sup> *Id.*

<sup>96</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KŪKŌ KEIEI KAIKAKU NO JITSUGEN NI MUKETE [TOWARD REALIZATION OF AIRPORT MANAGEMENT REFORM] 3 (2011), <https://www.mlit.go.jp/common/000161960.pdf> [<https://perma.cc/YC55-F6Q9>] (Japan).

<sup>97</sup> *Id.*

<sup>98</sup> PRINCIPLES, *supra* note 45, at III-2.

<sup>99</sup> *Id.*

<sup>100</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1-7(B).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

ownership of the terminal building from existing shareholders to the selected concessionaire.

In this setting, airport concessions require a fair-value assessment of the stock of the terminal building company at both the beginning and end of the operating period.<sup>104</sup> In the beginning, this involves private negotiations between the government and the original shareholders, a rare practice for a government that normally relies on the open market to decide the fair value of a trade.<sup>105</sup> Therefore, support is provided by financial advisors who conduct due diligence and valuation of the terminal building company. The government may have an incentive to lower the price of the stock because the lower it is, the higher will be the proceeds from the sale of the operating right. This is because bidders typically estimate the value of the integrated assets and allocate to the operating right the difference between that value and the prefixed price for the stocks.

There is a possibility that shareholders will refuse to sell their holdings even at a value they believe is fair. In this case, the government will have the de facto upper hand in negotiations, as it has the authority to renew the license of the terminal building company to operate the building every three years. The building typically stands on government-owned land, and the government explicitly conditions the renewal upon “cooperation with airport management reform,” which implies the integration of air- and land-side operations through concessions.<sup>106</sup> However, the process is not one-sided because the central government, in initiating concessions, is required to obtain the consent of the municipal government where the airport is located. The municipal government represents the interests of local constituencies, which include shareholders of the terminal building company.<sup>107</sup> For this reason, the central government often negotiates with municipal governments, which weighs the pros and cons of concession-led privatization. This can include benefits to the regional economy from an increase in inbound tourists and a possible renewal of assets, against concerns over a possible deterioration in the quality of the assets and a rise in prices, all of which are conceivable when altering a

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<sup>104</sup> *Id.* at II-1-7(B), (D).

<sup>105</sup> *Id.* at II-1-7(B).

<sup>106</sup> PRINCIPLES, *supra* note 45, at III-2(2).

<sup>107</sup> *Id.* at II-9.

government operation with a half-century of history.<sup>108</sup> This process is often a central part of decision-making on concessions.<sup>109</sup>

Fair value is a key issue arising at the end of the operating period. When the government decides to hold another competitive bidding process to renew a concession, the concessionaire will sell the terminal building to the next concessionaire; otherwise, the government can purchase the terminal building company by itself.<sup>110</sup> The government also prescribes an arbitration process to determine the price of transferred assets when a buyer, presumably the new concessionaire, and a seller, the existing one, disagree on the issue. Arbitrators consider the offer and bidding prices, as well as a valuation by a third party, agreed to by both the seller and the buyer.<sup>111</sup>

#### F. *Disclosure*

The concession process requires the disclosure of information on any infrastructure assets whose operating rights are to be transferred.<sup>112</sup> This step is necessary in order to resolve information gaps between the government and private bidders. A central element of fair value is fair disclosure, covering basic information on physical assets, operations, and financials.<sup>113</sup> Also included is sensitive information, such as security information on restricted airport areas, which is disclosed after candidates have been narrowed down by means of a first screening.<sup>114</sup> On-site visits are typically scheduled as well, often on multiple occasions.<sup>115</sup>

The disclosure process also includes a “competitive dialogue” where bidders, one by one, can examine the feasibility of possible operating ideas before formally proposing them in a bid.<sup>116</sup> Requests regarding the terms and conditions of concession contracts can also be

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<sup>108</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, *supra* 96, at 7.

<sup>109</sup> *Id.*

<sup>110</sup> CONTRACT, *supra* note 54, at art. 64.

<sup>111</sup> *Id.* at app. 14 (defining “Fair Value”).

<sup>112</sup> PRINCIPLES, *supra* note 45, at V.

<sup>113</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KŪKŌ TOKUTEI UN’EI JIGYŌ-TŌ BOSHŪ YŌKŌ [BIDDING AND SELECTION PROCEDURES ON THE CONCESSION OF SENDAI AIRPORT] III-2(F) (2017) [hereinafter PROCEDURES], <https://www.mlit.go.jp/common/001184836.pdf> [<https://perma.cc/78T9-DYGA>] (Japan).

<sup>114</sup> *Id.* at III-2(I).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at III-2(K).

conveyed to the government.<sup>117</sup> This is tailored more to specific bidders than the conventional process of “market sounding,” which is conducted by the government prior to competitive bidding to gauge the interest of potential bidders in specific infrastructure assets under tentative terms and conditions.<sup>118</sup> Ideas shared with the government during a competitive dialogue are kept confidential from competing bidders.<sup>119</sup> The time required for disclosure and competitive dialogue is a major reason why concession deals take over a year from inception to closing.<sup>120</sup>

Once selected, concessionaires must deal with the obligation of disclosure. Disclosure requirements include a summary of the proposed operating plan, an annual operating plan, and semiannual reviews and financial results.<sup>121</sup> The aim of disclosure is to provide the public with information on the privatized infrastructure. However, a disclosure made by concessionaires often lacks the granularity required for listed companies and is not comparable to what is typically included in annual reports corresponding to 10-K filings in the United States. In the case of airports, 10-K equivalent disclosures are filed only by the Narita Airport Co. and Central Japan International Airport Co. (“Centrair”), both of which are unlisted but required to file under Japanese financial regulations as they issue government-guaranteed bonds to general investors.<sup>122</sup> Disclosure by concessionaires should be improved to a 10-K equivalent level in order to maintain competitive pressure on the winner, even during the operating period, when potential future challengers are kept informed of replacements or other concession-related opportunities.<sup>123</sup>

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<sup>117</sup> *Id.*

<sup>118</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, SENDAI KŪKŌ TOKUTEI UN'EI JIGYŌ NO JISSHI NI KAKARU MAKETTO SAUNDINGU NO GOAN'NAI [NOTICE ON MARKET SOUNDING ON THE CONCESSION OF SENDAI AIRPORT] (Nov. 13, 2013), <https://www.mlit.go.jp/common/001018611.pdf> [<https://perma.cc/8LKV-MLKY>] (Japan).

<sup>119</sup> PROCEDURES, *supra* note 113, at III-2(K).

<sup>120</sup> *Id.* at III-2(A).

<sup>121</sup> CONTRACT, *supra* note 54, at arts. 31, 33-37.

<sup>122</sup> Kin'yū Shōhin Torihiki-hō [Financial Instruments and Exchange Act], Law No. 25 of 1948, art. 4(6) (Japan).

<sup>123</sup> Daisuke Asaoka, *The Financial Effect of Airport Concessions: An Empirical Analysis*, 46 INT'L J. TRANSP. ECON. 9 (2020).

### G. Competitive Bidding

In a competitive bid, participants are required to submit quantitative and qualitative proposals. Quantitative proposals including a bidding price for the operating right and capital expenditure plans for the operating period. Qualitative proposals include plans to operate the infrastructure assets and changes to the layouts and services provided.<sup>124</sup> Both types of proposals are legally binding unless noted otherwise, in which case they are given less consideration in evaluations.<sup>125</sup> In the case of airport concessions, capital expenditure plans usually cover the expansion of retail outlets, restaurants, and available departures and arrival gates, along with an overhaul of traffic lines to shorten the time required for check-in and boarding procedures.<sup>126</sup>

A competitive environment is a key factor in keeping the quality of infrastructure under concessions equal to or even better than that under government operation given that competition incentivizes bidders to submit the best possible plans and bidding prices. Without competition, the quality of infrastructure can deteriorate under private operation, with negative outcomes including higher prices for lower-quality services.<sup>127</sup> This can occur when the operator has bargaining power over a government that lacks alternative bidders. When Kansai Airport was privatized in 2015, only one consortium, led by Vinci of France, ended up participating in the final round of bidding.<sup>128</sup> Backed by this strong bargaining power, the sole bidder not only successfully landed the contract but also made the government adopt contractual changes after the entries were closed.<sup>129</sup> Among other stipulations, the

<sup>124</sup> PROCEDURES, *supra* note 113, at IX-3.

<sup>125</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-2-15.

<sup>126</sup> SENDAI INT'L AIRPORT CO., *supra* note 69.

<sup>127</sup> Heather Boushey & Helen Knudsen, *The Importance of Competition for the American Economy*, WHITE HOUSE (July 9, 2021), <https://www.whitehouse.gov/cea/written-materials/2021/07/09/the-importance-of-competition-for-the-american-economy/#:~:text=When%20there%20is%20insufficient%20competition,cannot%20become%20new%20goods%20and> [<https://perma.cc/MC7Q-VRXJ>].

<sup>128</sup> NEW KANSAI INT'L AIRPORT CO., KANSAIKOKUSAIKŪKŌ OYOBI ŌSAKAKOKUSAIKŪKŌ TOKUTEI KŪKŌ UN'EI JIGYŌ-TŌ' NO YŪSEN-KŌSHŌ-KENSHA NO SENTEI NI TSUITE [ON THE SELECTION OF THE PREFERRED NEGOTIATION PARTY FOR THE CONCESSION OF KANSAI INTERNATIONAL AIRPORT AND OSAKA INTERNATIONAL AIRPORT] (2015) [hereinafter SELECTION], <http://www.nkiac.co.jp/concession/second/pdf/second.pdf> [<https://perma.cc/SBB8-CJGR>] (Japan).

<sup>129</sup> NEW KANSAI INT'L AIRPORT CO., JISSHI KEIYAKU NO GAIYŌ NI TSUITE [ON THE SUMMARY OF THE CONCESSION CONTRACT] (2015),

amendment gave the concessionaire an explicit right to terminate the contract without penalty in the event of material adverse events.<sup>130</sup> It was a big win for the concessionaire, considering that the absence of such protection had discouraged other candidates from participating in the bidding process for a project with a long operating period of forty-four years.<sup>131</sup> Further, the concessionaire reduced some disclosures on airport usage which had been made before privatization, albeit the reduction was not a breach of the contract.<sup>132</sup> The degree of competitive pressure and bargaining power was different from what it would have been if at least one other bidder had participated.<sup>133</sup>

In a regular competitive bidding process with multiple bidders, the transparency and predictability of the grading criteria are key because they affect the candidates' proposals and overall willingness to participate.<sup>134</sup> Between the qualitative and quantitative criteria, the weight of the latter matters in terms of predictability as it leaves no room for exercising discretion in grading.<sup>135</sup> The quantitative weight ranges from 12% to 40% for airports and other types of concessions.<sup>136</sup> Arguably, however, a desirable weight would be at least more than half, considering the degree of subjective judgment involved in grading qualitative proposals.

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<http://www.nkiac.co.jp/concession/content/pdf/content01.pdf>  
[<https://perma.cc/XJ4X-MZ4B>] (Japan).

<sup>130</sup> *Id.*

<sup>131</sup> NEW KANSAI INT'L AIRPORT CO., KANSAIKOKUSAIKŪKŌ OYOBI ŌSAKAKOKUSAIKŪKŌ TOKUTEI KŪKŌ UN'EI JIGYŌ-TŌ' BOSHŪ YŌKŌ [BIDDING AND SELECTION PROCEDURES ON THE CONCESSION OF KANSAI INTERNATIONAL AIRPORT AND OSAKA INTERNATIONAL AIRPORT] II-2 (Nov. 12, 2014), <http://www.nkiac.co.jp/concession/content/pdf/content02.pdf> [<https://perma.cc/AM5Q-F5JB>] (Japan).

<sup>132</sup> Tadayuki Yoshikawa, *Kūkō Min'ei-ka de Sābisu Teika no Hiniku [Irony of Poor Quality After Concession]*, NIKKEI BUS. (Aug. 31, 2017), <https://business.nikkei.com/atcl/report/15/246820/082900064/> [<https://perma.cc/UGS6-G56B>] (Japan).

<sup>133</sup> Masahiro Nakagawa, *Kankū Shin-toppu ga Akasu "2-cho-en rakusatsu" no Shōsan: Orikkusu-ryū Keiei de Nippon no Kūkō wa kawaruka [The New CEO of Kansai Int'l Airport Reveals Winning Prospects of the "2-trillion-yen" Bidding: Will Japanese Airports Change by Orix's Management?]*, TOKYO KEIZAI ONLINE (Jan. 15, 2016), <https://toyokeizai.net/articles/-/100417> [<https://perma.cc/3B73-LWN7>].

<sup>134</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, MINKAN ITAKU KŪKŌ JŌKYŌ FORŌAPPU KAIGI TORIMATOME HŌKOKUSHO) [THE FOLLOW-UP REPORT ON THE STATUS OF AIRPORTS UNDER CONCESSIONS] 5 (2022) [hereinafter FOLLOW-UP], <https://www.mlit.go.jp/koku/content/001469293.pdf> [<https://perma.cc/Z8WQ-9SEU>] (Japan).

<sup>135</sup> *Id.*

<sup>136</sup> Asaoka, *supra* note 123, at 11.



Also, when “incumbent” shareholders of a terminal building company decide to participate in the bidding process, which is often the case, potential bidders may find there is a gap in experience and local knowledge that works against them. The importance of fair disclosure in this regard is to ensure fairness not only between sellers and buyers but also between competing buyers. One possible cure is to prohibit incumbent shareholders from participating altogether, although that might undermine equality of opportunity in an open bid. Alternatively, one might mandate that the airport terminal building company provide sufficient disclosure to resolve the information gap between incumbents and challengers, and prohibit the company from allowing its shareholders to access private information which affects competition. The latter fair-disclosure approach has been adopted in practice, but incumbent shareholders will often participate in and win, a bid by allying with third-party partners with more experience in operating infrastructure assets.<sup>137</sup> Cases like this include Fukuoka Airport; Kumamoto Airport, the country’s fifteenth largest; Hiroshima Airport, the seventeenth largest; and Hokkaido Airports, a bundle of seven airports in the Hokkaido region including six which are loss-making, and Shin-Chitose Airport, the country’s fifth largest, which makes up for their deficits.<sup>138</sup> The concession of Kansai Airport did not have the incumbent-challenger problem, but the winning consortium added thirty local partners after passing the first screening and learning that it was the only remaining bidder; these, which included

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<sup>137</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, FUKUOKA KŪKŌ TOKUTEI UN’EI JIGYŌ-TŌ NO YŪSEN KŌSHŌ-KEN-SHA SENTEI NI KAKARU KYAKKANTEKI HYŌKA KEKKA-TŌ NO KŌHYŌ NI TSUITE [ON THE SELECTION OF THE PREFERRED NEGOTIATION PARTY FOR THE CONCESSION OF FUKUOKA AIRPORT] (2018), <https://www.mlit.go.jp/common/001245372.pdf> [<https://perma.cc/LJ2D-38PC>] (Japan); MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KUMAMOTO KŪKŌ TOKUTEI UN’EI JIGYŌ-TŌ NO YŪSEN KŌSHŌ-KEN-SHA NO SENTEI NI TSUITE [ON THE SELECTION OF THE PREFERRED NEGOTIATION PARTY FOR THE CONCESSION OF KUMAMOTO AIRPORT] (2019), <https://www.mlit.go.jp/common/001282097.pdf> [<https://perma.cc/PYN4-WSEL>] (Japan); MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, HIROSHIMA KŪKŌ TOKUTEI UN’EI JIGYŌ-TŌ NO YŪSEN KŌSHŌ-KEN-SHA NO SENTEI NI TSUITE [ON THE SELECTION OF THE PREFERRED NEGOTIATION PARTY FOR THE CONCESSION OF HIROSHIMA AIRPORT] (2020), <https://www.mlit.go.jp/common/001362494.pdf> [<https://perma.cc/GNA4-RVCE>] (Japan); MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, HOKKAIDŌ-NAI 7 KŪKŌ TOKUTEI UN’EI JIGYŌ-TŌ NO YŪSEN KŌSHŌ-KEN-SHA NO SENTEI NI TSUITE [ON THE SELECTION OF THE PREFERRED NEGOTIATION PARTY FOR THE CONCESSION OF HOKKAIDO AIRPORTS] (2019), <https://www.mlit.go.jp/common/001296784.pdf> [<https://perma.cc/7PJP-PDE2>] (Japan).

<sup>138</sup> *Id.*

Panasonic and Nippon Life Insurance, own a total of 20% of the stock of the concessionaire SPV.<sup>139</sup>

If potential outside bidders find that the addition of incumbent shareholders to their consortium increases their chances to win a bid because of an actual or perceived informational advantage, it can lead to the undesirable result of having potential bidders vie for the incumbents' participation in their consortium, potentially giving them unfair weight at an entry point. Incumbent shareholders may also have an incentive to negotiate a higher value for their shareholdings in the airport terminal building company. This is because winning the bid results only in their repurchasing the stock they had agreed to sell, losing it brings them higher proceeds. It also raises an entry barrier for challengers, who must accept the higher value to participate. However, the fact that the government has an incentive to agree to a lower price for the stock likely offsets such an incentive.

#### H. *Force Majeure*

For Japan, having experienced the Great East Japan Earthquake in 2011 and the Covid-19 pandemic less than a decade later, risk allocation during natural disasters or pandemics is not a hypothetical issue.<sup>140</sup> Based on the public nature of infrastructure, the government accepts unlimited liability when infrastructure repairs caused by force majeure cost more than the amount covered by the insurance required of the concessionaire, thereby protecting investors through the concession contract.<sup>141</sup> This is a fair arrangement, given that concessionaires are expected to operate and maintain infrastructure in the government's place on the assumption that the assets are operative.

However, the effect of force majeure on the physical usability of infrastructure is one thing; its effect on financial performance is another. While the government assumes ultimate responsibility for the operability of infrastructure, it does not normally guarantee a level of demand, which is the core financial risk for an infrastructure operator.<sup>142</sup> The Covid-19 pandemic significantly affected the overall economic calculus of such investments, particularly those that depend for

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<sup>139</sup> SELECTION, *supra* 128.

<sup>140</sup> MINISTRY OF ECON., TRADE & INDUS., TSUSHŌ HAKUSHO 2021 [WHITE PAPER ON INTERNATIONAL ECONOMY AND TRADE 2021] 91, 93 (n.d.), <https://www.meti.go.jp/report/tsuhaku2021/pdf/02-01-02.pdf> [<https://perma.cc/K3WK-3HLM>] (Japan).

<sup>141</sup> CONTRACT, *supra* note 54, at art. 46(3).

<sup>142</sup> *Id.* at art. 48(1).

revenue on the movement of people, notably the inbound tourists whose numbers plunged to abnormally low levels during the lockdowns.<sup>143</sup> It also raised awareness of the need for a fair allocation of risk between public and private through contractual and regulatory design.<sup>144</sup>

In fact, the government gave only limited support to the concessionaires of airports that continued operating during the pandemic. The concessionaire of Fukuoka Airport fell into insolvency in 2021,<sup>145</sup> its debt exceeding its assets by \$30 million (3.6 billion yen), although additional bank borrowings carried it through the pandemic. The government agreed to allow it to delay the timing of pledged capital expenditures and annual operating right payments at no additional cost, essentially providing the troubled concessionaire with bridge financing. In the case of the Fukuoka and Hokkaido airports, the government additionally agreed to extend the operating period by one year, meaning that the concessionaires will earn an annual profit from operating the airports without additional payment.<sup>146</sup> This was made possible under a clause originally intended for government compensation cases allowing an extension of the agreement on a yearly basis for up to five years.<sup>147</sup>

The ex-ante possibility of concessionaires falling into financial instability is something to be accepted when a concessionaire undertakes financial risk in place of the government. If the government were

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<sup>143</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, *supra* note 94, at 13.

<sup>144</sup> FOLLOW-UP, *supra* note 134, at 8.

<sup>145</sup> FUKUOKA INT'L AIRPORT CO., DAI 3-NENDO NENJI HÖKOKU-SHO [ANNUAL REPORT FOR THE 3RD FISCAL YEAR] 13 (2020), [https://www.fukuoka-airport.co.jp/uploads/2021/06/fiac\\_2020\\_.pdf](https://www.fukuoka-airport.co.jp/uploads/2021/06/fiac_2020_.pdf) [<https://perma.cc/C8AK-MDTL>] (Japan).

<sup>146</sup> *See generally* MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KORONA JIDAI NO KÖKÜ KÜKÖ NO KEIEI KIBAN KYÖKA NI MUKETA SHIEN SHISAKU PAKKĒJI [THE SUPPORT POLICY PACKAGE FOR AIRPORTS UNDER THE COVID-19 PANDEMIC] (2020), <https://www.mlit.go.jp/report/press/content/001379362.pdf> [<https://perma.cc/3JZX-CHBQ>] (Japan); *see also* Kei Shirakawa, *Konseshon Kükō Shien Pakkēji* [Support Package for Airports under Concession], 25 MORI HAMADA & MATSUMOTO ENERGY & INFRASTRUCTURE BULL. 1 (Nov. 2020), [https://www.mhmjapan.com/content/files/00043638/EI%20Bulletin%20vol25\\_202011.pdf](https://www.mhmjapan.com/content/files/00043638/EI%20Bulletin%20vol25_202011.pdf) [<https://perma.cc/86GP-X969>] (Japan).

<sup>147</sup> *See, e.g.*, MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, FUKUOKA KÜKÖ TOKUTEI UN'EI JIGYÖ-TÖ KÖKYÖ SHISETSU-TÖ UN'EI-KEN JISSHI KEIYAKUSHO [CONCESSION CONTRACT FOR FUKUOKA AIRPORT], arts. 48(2), 62(2) (2018) [hereinafter FUKUOKA CONTRACT], <https://www.mlit.go.jp/common/001246377.pdf> [<https://perma.cc/6YTY-34B2>] (Japan).

to decide ex-post to take on most of the burden of force majeure beyond the requirements stipulated in a contract, it would make private investors immune from such extraordinary events and make infrastructure more resilient to events such as natural disasters and pandemics. However, such ex-post behavior would undermine discipline and affect the perception of concessionaires, potentially causing them to seek to negotiate room during downturns at the taxpayer's expense. In its actual responses, the government seems to be trying to balance such conflicting effects. While lending support during the unprecedented pandemic, it has sought to maintain discipline by sticking to the letter of the contract and providing a certain level of funds. One of the government's perceived roles is to keep the country's infrastructure functioning soundly overall, even during a crisis.<sup>148</sup> But an expectation of government support during a crisis could easily lead to moral hazard, should concessionaires lose the incentive to prepare for severe economic downturns. It might also have an additional, subtle effect on the government that could regain its influence when turned to by concessionaires as a last resort, even with overall government policy moving in the direction of privatization.

### I. Profit Sharing

While the government and operators share risks, they may share profits as well. Some arrangements prescribe that a share of profits exceeding a specified threshold be paid to the government. Such arrangements were adopted in the concessions of Kansai Airport, Fukuoka Airport, and Hokkaido Airports, as these are relatively large facilities and the upsides of privatization can be significant.<sup>149</sup> This arrangement, combined with that for force majeure, moderates the risks of infrastructure investment by keeping the profits and losses of

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<sup>148</sup> CABINET OFF. OF JAPAN, BOSAI HAKUSHO REIWA 3-NEN [WHITE PAPER ON DISASTER MANAGEMENT 2021] 102 (n.d.) [https://www.bousai.go.jp/kaigirep/hakusho/pdf/r3\\_dai1bu1-2.pdf](https://www.bousai.go.jp/kaigirep/hakusho/pdf/r3_dai1bu1-2.pdf) [<https://perma.cc/D4T6-KRW8>].

<sup>149</sup> NEW KANSAI INT'L AIRPORT CO., *supra* note 131, at II-8; MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, FUKUOKA KŪKŌ TOKUTEI UN'EI JIGYŌ-TŌ BOSHŪ YŌKŌ [BIDDING AND SELECTION PROCEDURES ON THE CONCESSION OF FUKUOKA AIRPORT] II-17 (2017) [hereinafter FUKUOKA PROCEDURES], <https://www.mlit.go.jp/common/001184836.pdf> [<https://perma.cc/8FUM-SN8B>] (Japan); MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, HOKKAIDO-NAI 7 KŪKŌ TOKUTEI UN'EI JIGYŌ-TŌ BOSHŪ YŌKŌ [BIDDING AND SELECTION PROCEDURES ON THE CONCESSION OF HOKKAIDO 7 AIRPORT] II-16 (2018), <https://www.mlit.go.jp/common/001232803.pdf> [<https://perma.cc/P7N5-8EQE>] (Japan).

private investors within a reasonably predictable range.<sup>150</sup> The effect is similar to that of an earnout, which is often found in merger and acquisition contracts to adjust the target firm's value to outcomes occurring after the closing of the transaction.<sup>151</sup> The uncertainty of future events translates into conditional payment, thereby facilitating agreements made under conditions of uncertainty.<sup>152</sup>

A more controlled version of risk limitation is seen in the case of Aichi Toll Roads, a local network of toll roads in Aichi Prefecture in central Japan.<sup>153</sup> In this unique case, the government takes all profits that result from road traffic exceeding 106% of the projected demand set at the beginning of the operating period, while compensating for all losses that result from road traffic falling below 94% of the projection.<sup>154</sup> Under the arrangement, a concessionaire assumes the risk of demand only within this range, while the government undertakes the rest.<sup>155</sup> In this case, the government essentially pays for the availability of toll roads by only partially transferring the financial risks and rewards to the concessionaire.

#### J. ESG Considerations

Given the public nature of infrastructure assets, their ESG impacts are multi-faceted. Their operation may have a considerable environmental impact, for example, and through their operation, they may create substantial local employment, often as key employers in their region. To encourage concessionaires in their ESG initiatives, competitive bidding processes typically include the evaluation of proposals from an ESG perspective.<sup>156</sup> Proposals for airport concessions include measures for noise reduction, a serious concern for airports located in a downtown area.<sup>157</sup> Fukuoka Airport, for example,

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<sup>150</sup> *Id.*

<sup>151</sup> Albert H. Choi, *Addressing Informational Challenges with Earnouts in Mergers & Acquisitions*, in RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 154, at 154 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

<sup>152</sup> *Id.*

<sup>153</sup> AICHI PREFECTURAL ROAD PUB. CORP., AICHI YŪRYŌ DŌRO NO KONSESSHON KEIYAKU NI TSUITE [ON THE CONCESSION CONTRACT FOR AICHI TOLL ROADS] (2016), <http://www.aichi-dourokousha.or.jp/wp-content/uploads/2016/08/2-gaiyou-shuusei.pdf> [<https://perma.cc/3E7R-XMCX>] (Japan).

<sup>154</sup> *Id.*

<sup>155</sup> *Id.*

<sup>156</sup> FUKUOKA PROCEDURES, *supra* note 149, at II-10I, (D); FUKUOKA CONTRACT, *supra* note 147, at art. 26-4.

<sup>157</sup> FUKUOKA PROCEDURES, *supra* note 149, at II-10I, (D); FUKUOKA CONTRACT, *supra* note 147, at art. 26-4.

connects to the city center by subway in only five minutes, and thus causes significant noise and vibration in the neighborhood.<sup>158</sup> The airport has made a number of efforts to benefit nearby residents, including building parks, providing free medical checkups, and donating air conditioners to homes whose windows must be kept closed due to noise.<sup>159</sup> In addition, the government continues to provide a budget for the purchase of residents' land at their request.<sup>160</sup> Both the central and municipal governments had performed these roles even before the airport's privatization, but the transfer to the private sector seems to have increased their flexibility in dealing with such issues. Other proposals could include plans to support local industries and communities through local sourcing and employment opportunities for residents.

Gender diversity has also been emphasized, notably, since the enactment of the Basic Act for a Gender Equal Society in 1999.<sup>161</sup> Although the government failed to achieve a goal set in 2010 to increase the ratio of women in managerial positions to 30% by 2020, its overall policy direction is to correct the gender-related aspects of social injustice.<sup>162</sup> In fact, the ratio of women managers at private firms in 2021 was a mere 13.2%, well below the ratios of 41.1% in the United States, 36.8% in the U.K., 34.2% in France, and 29.4% in Germany.<sup>163</sup> Within the government, the ratio is even lower at 4.2% for top officials and 4.9% for middle managerial positions.<sup>164</sup> While the gap remains substantial, concessions have had a moderating effect on gender inequality by promoting proposals that would work to correct imbalances.

Because bid proposals typically include governance architecture, a concession's operation is self-monitored and designed to augment government inspections conducted with and without notice.<sup>165</sup> Self-monitoring is an important design element in that privatization removes the government's access to first-hand, real-time information on

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<sup>158</sup> FUKUOKA INT'L AIRPORT CO., FUKUOKA KŪKŌ KANKYŌ SEIBI JOSEI JIGYŌ JISSHI YŌRYŌ [SUMMARY OF ENVIRONMENTAL SUPPORT AT FUKUOKA] (2019), [https://www.fukuoka-airport.jp/assets/social/pdf/01\\_guidelines.pdf](https://www.fukuoka-airport.jp/assets/social/pdf/01_guidelines.pdf) [<https://perma.cc/E25H-V7NN>] (Japan).

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> CABINET OFF. OF JAPAN, JENDĀ BYŌDŌ NI KANSURU HAKUSHO [THE WHITE PAPER ON GENDER EQUALITY 2022] (2022), [https://www.gender.go.jp/about\\_danjo/whitepaper/r04/zentai/pdf/r04\\_print.pdf](https://www.gender.go.jp/about_danjo/whitepaper/r04/zentai/pdf/r04_print.pdf) [<https://perma.cc/FG87-3C5G>] (Japan).

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> CONTRACT, *supra* note 54, arts. 51-52.

an infrastructure asset.<sup>166</sup> Self-monitoring is normally conducted through internal committees which examine compliance, safety, and quality of operation, and is often reinforced by independent third-party monitors supported by consultants.<sup>167</sup> However, since concessionaires, or the SPVs that own the concession's operating rights, are unlisted corporations, their boards tend to be filled with the representatives of consortium members, which leaves little room for independent outside directors.<sup>168</sup> This stands in contrast to the situation at the sponsor level. Sponsors have often listed companies, which are required under the Japanese corporate governance code introduced in 2015 and amended in 2021, to have at least two independent board directors or even a third to qualify for a prime listing on the Tokyo Stock Exchange.<sup>169</sup>

As with the bidding price for the operating rights, the fundamental assumption on the ESG front is that competition incentivizes bidders to come up with better ESG initiatives that go beyond the minimum levels required by the government. Therefore, a competitive environment for selecting concessionaires is essential to promoting better ESG initiatives as well.

### III. COMPARISON WITH STOCK SALES

#### A. Overview

Even after the introduction of concessions, stock sales continued to be used as a format for privatization. However, there have been only two cases: (1) the privatization of the Japan Post group, including its two subsidiaries; and (2) Japan Railway ("JR") Kyushu. And even in these two cases, the government had already decided on using stock sales before the legislation of concessions in 2011.<sup>170</sup> The same is true of a stock sale planned for Tokyo Metro Co., a major subway operator, which was corporatized in 2004 with a stock sales plan albeit without

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<sup>166</sup> *Id.*

<sup>167</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, MONITARINGU NI TSUITE [ON MONITORING] (n.d.), <https://www.mlit.go.jp/mizukokudo/sewerage/content/001429232.pdf> [<https://perma.cc/PD9X-4EHS>] (Japan).

<sup>168</sup> SENDAI INT'L AIRPORT CO., DAI-7-KI JIGYŌ HŌKOKU [ANNUAL REPORT, 7<sup>TH</sup> FISCAL YEAR] 7 (n.d.), <https://www.sendai-airport.co.jp/wp/wp-content/uploads/2022/06/2021jigyō.pdf> [<https://perma.cc/47HB-SBQB>] (Japan).

<sup>169</sup> TOKYO STOCK EXCH., JAPAN'S CORPORATE GOVERNANCE CODE: SEEKING SUSTAINABLE CORPORATE GROWTH AND INCREASED CORPORATE VALUE OVER THE MID- TO LONG-TERM 23 (2021), <https://www.jpx.co.jp/81ilt81u81/equities/listing/cg/tvdivq0000008jdy-att/20210611.pdf> [<https://perma.cc/DHQ5-QCZ2>].

<sup>170</sup> *See* Table 1 and Appendix.

a specific deadline.<sup>171</sup> After the 2011 earthquake, the government decided that proceeds from the stock sale would be spent on the redemption of bonds issued to finance earthquake reconstruction.<sup>172</sup> In 2021, seventeen years after the company's corporatization, a government panel approved the sale of half its stock.<sup>173</sup>

In the case of the Japan Post group, the use of a stock sale had been decided in 2005 under the Koizumi administration, six years before the concession format was legislated.<sup>174</sup> Corporatization of the group was completed in 2007, followed by a stock sale held in 2015 through simultaneous IPO by Japan Post Holdings Co. and its subsidiaries, Japan Post Bank and Japan Post Insurance.<sup>175</sup> The result was the privatization of a conglomerate offering postal, banking, and insurance services through a local network of 24,284 post offices employing 389,000 people.<sup>176</sup>

Under the group's privatization program, the government must hold more than a third of the shares of Japan Post Holdings Co., the holding company.<sup>177</sup> As of May 2022, seven years after its initial

<sup>171</sup> Tōkyō Metoro Kabushikigaisha-hō [Act on Tokyo Metro Corporation], Law No. 188 of 2002, Supp. Provision art. 2 (Japan).

<sup>172</sup> Higashi-nihon Dai-shinsai Fukkō Zaigen Kakuho-hō [Act on Securing Finance for Recovery from the Great East Japan Earthquake], Law No. 117 of 2011, art. 72 (Japan).

<sup>173</sup> COUNCIL ON TRANSP. POL'Y OF JAPAN, TŌKYŌ-KEN NI OKERU KONGO NO CHIKATETSU NETTOWĀKU NO ARIKATA-TŌ NI TSUITE [ON THE SUBWAY NETWORK SERVING THE TOKYO METROPOLITAN AREA] 9 (2021), <https://www.mlit.go.jp/policy/shingikai/content/001414998.pdf> [<https://perma.cc/7PKG-W88R>] (Japan); Emi Urabe, *Tōkyō Metoro Jōjō e Kabu Baikyaku, Kuni to To ga Gōi – Shinsen Seibi de Renkei* [Central Government and Tokyo Metropolitan Government Agree on Stock Sales for Tokyo Metro], BLOOMBERG (July 15, 2021, 6:44 PM), <https://www.bloomberg.co.jp/news/articles/2021-07-15/QWA0JMT0AFB601> [<https://perma.cc/E7J6-RX6U>] (Japan).

<sup>174</sup> Yūsei Min'eikahō [Postal Service Privatization Act], Law No. 97 of 2005, art. 7 (Japan).

<sup>175</sup> Mai Omori, *Nihon-Yūsei Gurūpu 3-sha no Kabushiki Jōjō to Kongo no Kadai* [Initial Public Offerings of the Three Companies of Japan Post Group and the Future Issues], 371 RIPPŌ TO CHŌSA [LEGIS. AND RSCH.] 133, 133, 138 (Dec. 2015), [https://www.sangiin.go.jp/82ilt82u82e/annai/chousa/rip-pou\\_chousa/backnumber/2015pdf/20151201133.pdf](https://www.sangiin.go.jp/82ilt82u82e/annai/chousa/rip-pou_chousa/backnumber/2015pdf/20151201133.pdf) [<https://perma.cc/P57J-JVV4>].

<sup>176</sup> JAPAN POST GRP., NENJI KAIJI 2022 [ANNUAL DISCLOSURE 2022] 14 (2022), [https://www.japanpost.jp/ir/library/disclosure/2022/pdf/int\\_all\\_01.pdf](https://www.japanpost.jp/ir/library/disclosure/2022/pdf/int_all_01.pdf) [<https://perma.cc/H4AX-LP5E>] (Japan).

<sup>177</sup> Yūsei Min'eikahō [Postal Service Privatization Act], Law No. 97 of 2005, art. 7 (Japan); see also MINISTRY OF INTERNAL AFFS. AND COMMC'NS, DEJITARU JIDAI NI OKERU YŪSEI JIGYŌ NO ARIKATA NI TSUITE [POSTAL SERVICES IN THE DIGITAL ERA] (2021), [https://www.soumu.go.jp/main\\_content/000716907.pdf](https://www.soumu.go.jp/main_content/000716907.pdf) [<https://perma.cc/6FM9-46GQ>] (Japan).



public offering, the government owned 34.3% of the shares.<sup>178</sup> The requirement is slightly different from that for NTT, where the government must hold a third of shares or more.<sup>179</sup> The difference between “more than a third” and “a third or more” is significant in that under Japanese corporate law, key decisions such as mergers, asset sales, and other reorganizations, as well as amendments to articles of incorporation, require approval by two-thirds of shareholders.<sup>180</sup> The partially privatized holding company is required to hold 100% of Japan Post Co., a subsidiary offering postal and delivery services.<sup>181</sup> This means that the government maintains indirect ownership of more than a third of the postal arm through its ownership of the parent.

In contrast to the requirement for the postal arm, the holding company is required to sell all of its holdings in its banking subsidiary, Japan Post Bank Co., and its insurance subsidiary, Japan Post Insurance Co., albeit without an explicit deadline.<sup>182</sup> The holding company has an intermediate goal of reducing its ownership of the two subsidiaries to 50%, below which threshold the government loses the authority to approve the subsidiaries’ entry into new businesses.<sup>183</sup> In May 2021, the holding company bought back 14.58% of shares in the insurance subsidiary, which resulted in holdings of 49.90% and achieved the intermediate goal.<sup>184</sup> It announced that it would lower its holdings in the banking subsidiary as well, from 89% to 50% or less, soon after the start of its five-year management plan starting in the same year.<sup>185</sup>

The other stock sale, for JR Kyushu, occurred in 2016, one year after the IPO of the Japan Post group.<sup>186</sup> The choice of format dates back to 1985 when the state-owned JNR was mired in myriad labor

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<sup>178</sup> See JAPAN POST GRP., *supra* note 176, at 36.

<sup>179</sup> Nippon Denshin Denwa-hō [Nippon Telegraph and Telephone Act], Law No. 85 of 1984, art. 4 (Japan).

<sup>180</sup> Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 309(2) (Japan).

<sup>181</sup> Yūsei Min’cikaihō [Postal Service Privatization Act], Law No. 97 of 2005, art. 6 (Japan).

<sup>182</sup> *Id.* at art. 7.

<sup>183</sup> *Id.* at arts. 110, 110-2(1), 138, 138-2(1).

<sup>184</sup> See JAPAN POST GRP., *supra* note 176, at 36-37.

<sup>185</sup> JAPAN POST GRP., JP BIJON 2025 [JP VISION 2025] (2021), [https://www.japanpost.jp/ir/strategy/pdf/20210514\\_01\\_st.pdf](https://www.japanpost.jp/ir/strategy/pdf/20210514_01_st.pdf) [<https://perma.cc/DEE6-47LR>] (Japan).

<sup>186</sup> Keiji Hatano & Izumi Akai, *Kyushu Railway Completes Japan’s Largest IPO by Offering Size of 2016*, SULLIVAN & CROMWELL LLP (Oct. 25, 2016), <https://www.sullcrom.com/83ilt83u-railway-company-completes-japans-largest-ipo-2016> [<https://perma.cc/6Q4U-XV79>].

disputes.<sup>187</sup> The government decided to solve the deadlocks by splitting the company into six regional JR companies that year, their stock to be sold through listings.<sup>188</sup> The three most profitable, JR East, JR West, and JR Central, listed their stock in 1993, 1996, and 1997 respectively, and completed the government's full stock sales by 2002, 2004, and 2006.<sup>189</sup>

The JR Kyushu listing was fourth out of the six. The two remaining regional railway companies, JR Hokkaido and JR Shikoku, have no prospect of a public listing because their operations are loss-making, serve less populated areas than the other four, and are supported by government subsidies.<sup>190</sup> The two received additional subsidies of \$1.1 billion (130.2 billion yen) and \$0.8 billion (102.5 billion yen) respectively during the Covid-19 pandemic, while the others did not.<sup>191</sup> The listing of JR Kyushu, whose entire stocks were sold at once at a valuation of \$3 billion (0.4 trillion yen), was possible only after the company grew its non-railway divisions, such as real estate, to compensate for the losses of its railway business.<sup>192</sup> The rare listing of a public infrastructure company confirmed a general trend that had been conspicuous since the 2000s – an activist fund, Fir Tree, had accumulated holdings in the company shortly after the initial public offering to demand the appointment of three independent directors based on its proposals.<sup>193</sup> While Institutional Shareholders Services supported two

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<sup>187</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KOKUTETSU NO BUNKATSU MIN'EIKA KARA 30-NEN O MUKAETE [30 YEARS AFTER THE PRIVATIZATION OF JAPAN NATIONAL RAILWAYS] (2017), <https://www.mlit.go.jp/common/001242868.pdf> [<https://perma.cc/F8CV-CBPH>] (Japan); see also MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, IWAYURU 1047-MEI MONDAI NI KANSURU WAKAI NO SEIRITSU NI TSUITE [THE SETTLEMENT OF LABOR DISPUTES] (n.d.), <https://www.mlit.go.jp/common/000117516.pdf> [<https://perma.cc/2QQ2-7CSE>] (Japan).

<sup>188</sup> *Id.*

<sup>189</sup> *JR Kabushiki no Shobun* [Stock Sales of Japan Railways], JAPAN RY. CONSTR., TRANSP. & TECH. AGENCY, <https://www.jrtt.go.jp/settlement/share.html> [<https://perma.cc/2NHN-SE5R>] (last visited Sept. 24, 2022) (Japan).

<sup>190</sup> Press Release, Ministry of Land, Infrastructure, Transp. and Tourism, JR Hokkaidō, JR Shikoku-tō ni Taisuru Shien o Keizoku Kakujū Shimasu [We will Continue and Expand Support for JR Hokkaido, JR Shikoku, etc.] (Dec. 25, 2020), <https://www.mlit.go.jp/report/press/content/001380813.pdf> [<https://perma.cc/GN2V-R595>] (Japan).

<sup>191</sup> *Id.*

<sup>192</sup> Daisuke Asaoka & Yoshihisa Sugimura, *The Effect of Privatization on Performance and Return: The Case of Japanese Railway Company*, 2019 GLOB. BUS. ECON. ANTHOL. 16, 22 (2019).

<sup>193</sup> GIKETSUKEN KŌSHI JOGEN KAISHA (ISS) NO REPŌTO NI TAISURU TŌSHA NO KENKAI NI TSUITE [OUR VIEWS ON PROXY ADVISORY FIRM (ISS) REPORTS], JAPAN

of them,<sup>194</sup> all three candidates were rejected in 2020 at the company's shareholders' meeting, with approval rates ranging from 15.1% to 32.6%.<sup>195</sup>

Along with being a means of promoting privatization, the introduction of concessions in 2011 seems to have been in response to the surge in stock market activism of the 2000s.<sup>196</sup> But that was not the only factor. It is worthwhile to compare the formats, as is done in the remaining part of this section, noting the obvious difference between public and private transactions.

### B. *Economics*

The first viewpoint focuses on the proceeds that the government secures through privatization.<sup>197</sup> Given that a fundamental motivation for privatization is to mitigate the burden of debt taken on by the public, maximizing proceeds is an integral factor in choosing a format. If the government fails to maximize proceeds by choosing a concession over a stock sale, it means it has compromised on proceeds for the sake of securing control. However, as shown below, concessions tend to be superior to stock sales in terms of expected proceeds.<sup>198</sup> The exception would be in a high-interest rate environment, which is the opposite of Japan's reality.<sup>199</sup>

Under the principle of corporate finance, the value that the government receives through stock sales or concessions is determined by the present value of future cash flows.<sup>200</sup> Suppose that a project to be

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RY. KYUSHU (June 10, 2020), [https://www.jrkyushu.co.jp/company/ir/stock/meeting/\\_icsFiles/afieldfile/2020/06/10/9142\\_viewonIssreport\\_jp\\_1.pdf](https://www.jrkyushu.co.jp/company/ir/stock/meeting/_icsFiles/afieldfile/2020/06/10/9142_viewonIssreport_jp_1.pdf) [<https://perma.cc/66JG-BHGF>] (Japan).

<sup>194</sup> *Id.*

<sup>195</sup> RINJI-HŌKOKUSHO NO TEISEI-HŌKOKUSHO [ON THE CORRECTION OF ERRORS IN THE FILING OF EXTRAORDINARY REPORTS], JAPAN RY. KYUSHU (2020), [https://www.jrkyushu.co.jp/company/ir/stock/meeting/\\_icsFiles/afieldfile/2020/10/12/rinji\\_33rd\\_02.pdf](https://www.jrkyushu.co.jp/company/ir/stock/meeting/_icsFiles/afieldfile/2020/10/12/rinji_33rd_02.pdf) [<https://perma.cc/7H75-MEEN>] (Japan).

<sup>196</sup> *Supra* Part I.

<sup>197</sup> CABINET OFF. OF JAPAN, KŌKYŌ SHISETSU-TŌ UN'EI-KEN OYOBI KŌKYŌ SHISETSU-TŌ UN'EI JIGYŌ NI KANSURU GAIDORAIN [GUIDELINES FOR PUBLIC FACILITIES OPERATING RIGHT AND PUBLIC FACILITIES OPERATING BUSINESS] 7-1 (2021), [https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken\\_guideline.pdf](https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken_guideline.pdf) [<https://perma.cc/9X29-AQ6G>].

<sup>198</sup> *Infra* Part III(B).

<sup>199</sup> *Kin'yū Seisaku no Gaiyō* [The Summary of Monetary Policy], BANK OF JAPAN, <https://www.boj.or.jp/mopo/outline/index.htm> [<https://perma.cc/58X4-RAP6>] (last visited Nov. 1, 2022) (Japan).

<sup>200</sup> BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89, at 23.

privatized generates an annual after-tax free cash flow of 100, and the discount rate is 8%. With a stock sale, the government receives the value of a perpetuity, which is  $100/.08$  or 1,250. With a concession, the government receives the present value of future cash flows for a prespecified period. When the operating period is thirty years, it receives the value of an annuity of 100 during that period, whose present value is  $100 \times (1 - 1/1.08^{30})/.08$  or 1,126, by applying the formula for an annuity.<sup>201</sup> The stock sale appears to give a higher value, at  $1,250 > 1,126$  under the discount rate of 8%.

However, a government that chooses concessions can enjoy a “double dip” by reselling the operating right to the same infrastructure through another round of concessions after the first operating period ends.<sup>202</sup> If one assumes that the business risk is unchanged, future cash flows during the second period are discounted by the same 8%, and the government again receives 1,126 at the beginning of the second operating period or thirty years from the present.<sup>203</sup> To further discount the value of the proceeds back to the present, the government applies a lower discount rate than 8%.<sup>204</sup> It does so because its uncertainty concerns not its business risk, but its own decision to have a second round – an issue that has nothing to do with intrinsic business risk. This is where the difference between the private and the public becomes apparent: when making financing and other decisions, the government generally faces a lower discount rate than the private sector.<sup>205</sup> If one assumes a rate of 2%, meaning that a thirty-year government bond is issued at that rate, the present value of the two rounds of concessions is  $1,126 + 1,126/1.02^{30}$  or 1,747, which is higher than the one-time proceeds of 1,250 for stock sales. The difference becomes greater as the government seeks further rounds of concessions, though its marginal contribution becomes smaller. More importantly, even if the government does not seek one or more further rounds of concessions, the economic effect is the same.<sup>206</sup> As long as it regains economic interest in the infrastructure after the first operating period, it receives the value regardless of whether the asset is privatized again or remains under its own operation.<sup>207</sup>

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<sup>201</sup> *Id.* (Or,  $100/1.08 + 100/1.08^2 + \dots + 100/1.08^{30} = 1,126$ ).

<sup>202</sup> *See id.* at 122.

<sup>203</sup> *See id.* at 23.

<sup>204</sup> *Id.*

<sup>205</sup> *See id.* at 74.

<sup>206</sup> *See* BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89, at 37-38.

<sup>207</sup> *Id.*

The break-even discount rate for the government in this example – where the value for the two formats is equal – is 7.6%, where  $1,250 = 1,126 + 1,126/1.07630$ . This rate is unreasonably high for the government of an advanced economy, and in particular for Japan, which has been operating in a chronically low, or even negative, interest environment.<sup>208</sup> Hence, it is reasonable in terms of economics for the Japanese government to prefer concessions over stock sales when it sees the need to privatize. Alternatively, if one assumes a government bond rate of 2%, the break-even discount rate for risky future cash flows is 3.5%, or  $100/.035 = \{100 \times (1 - 1/1.03530)/.035\}/1.0230$ , it is not unreasonable to assume a discount rate above this figure for the business risk of cash flows generated from an infrastructure asset such as an airport, making concessions more desirable.

Concessions have an additional benefit in respect of proceeds. This derives from the depreciation and accompanying tax deductions allowed for the operating right under Generally Accepted Accounting Principles (“GAAP”).<sup>209</sup> In a fairly priced deal, a concessionaire pays the present value of future tax shields and enjoys the benefits later.<sup>210</sup> In this example, the government essentially borrows from the concessionaire in the form of a prepayment of the value of the tax shields and repays the amount in the form of a corresponding tax break later. When the corporate tax rate is 30%, the discount rate 8%, and the price for the operating right  $x$ , the concessionaire receives an annual tax break of  $x/30 \times 30\%$  under straight-line depreciation. If one assumes that the amount of depreciation for accounting purposes is equal to that for tax purposes, the price for the operating right with such tax breaks satisfies an equation of  $x = (100 + x/30 \times 30\%)/1.08 + (100 + x/30 \times 30\%)/1.082 + \dots + (100 + x/30 \times 30\%)/1.0830$ , which returns  $x = 1,269$ . From this result, the annual tax break is  $1,269/30 \times 30\%$ , or 13. In total, the concessionaire pays 1,269 to receive over thirty years an annual cash flow of 100, and a tax break of thirteen, for a total of 113. The difference between 1,269 and the

<sup>208</sup> BANK OF JAPAN, *supra* note 199.

<sup>209</sup> Joanne Flood, *ASC 853: Service Concession Arrangements*, in WILEY GAAP 2020: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, ch. 61 (2020); *IAS 16 Property, Plant and Equipment*, IFRS FOUND., <https://www.ifrs.org/issued-standards/list-of-standards/ias-16-property-plant-and-equipment/> [<https://perma.cc/PT6B-GM64>] (last visited Sept. 24, 2022); *IFRIC 12 Service Concession Arrangements*, IFRS FOUND., <https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standards/ifric-12> [<https://perma.cc/U4Q2-LZJV>] (last visited Sept. 24, 2022).

<sup>210</sup> See BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89, at 28.

value without tax breaks, 1,126, is the present value of the annuity of the tax breaks,<sup>211</sup> or  $13 \times (1 - 1/1.0830)/.08$ , resulting in 143.

However, this borrowing is costly for a government. Since a government generally has a higher credit than a concessionaire, and thus a lower borrowing rate, it does not make sense to borrow at a higher rate that reflects a concessionaire's lower credit.<sup>212</sup> In calculating the present value of future tax breaks, the concessionaire applies a higher discount rate than the government, as the discount rate reflects the business risk of its failure to generate sufficient taxable income to match deductions through depreciation, which is 8% in the above example.<sup>213</sup> In essence, this means that the government chooses to borrow at the same rate as a private concessionaire.<sup>214</sup> Thus, it is financially unreasonable for the government to allow a tax deduction for depreciation of the operating right, even if the depreciation is allowed for accounting purposes, to the extent that the deduction is reflected in the bidding price for the depreciable operating right.

In total, these calculations reveal that concessions are a superior format to stock sales in terms of economics in that the former brings greater proceeds to the government's coffers. However, by allowing tax deductions the government also lets itself borrow at an unreasonably higher rate than its own debt cost.

### C. Strategy

One of the major advantages of privatization is the flexibility it gives to investment decisions compared to those made under the control of a government tied to annual fiscal budgets.<sup>215</sup> It may be hard for a government official to postpone investments once a budget is allocated, as such a move could weaken arguments for future budget reallocation. It may also be hard to make preventative investments – investments made in maintenance before an asset deteriorates – even if they could lower total investment costs over the years, as the case for investing in evidently deteriorating assets looks more compelling as

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<sup>211</sup> Or,  $13/1.08 + 13/1.08^2 + \dots + 13/1.08^{30} = 143$ . Values do not match exactly due to rounding.

<sup>212</sup> See BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89, at 75-76.

<sup>213</sup> See *id.* at 158.

<sup>214</sup> BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89.

<sup>215</sup> MINISTRY OF FIN. OF JAPAN, KURIKOSHI GAIDOBUKKU, KAITEI-BAN [GUIDEBOOK ON CARRY-OVER] (revised ed., June 2020), [https://www.mof.go.jp/policy/budget/topics/kurikoshi/r2guidebook/r2guidebook\\_all.pdf](https://www.mof.go.jp/policy/budget/topics/kurikoshi/r2guidebook/r2guidebook_all.pdf) [<https://perma.cc/R9EK-X4JM>] (Japan).

part of an annual budget allocation process.<sup>216</sup> Private concessionaires find it easier to see things in terms of life-cycle cost, as they have a stronger incentive to minimize total costs than to justify annual budget allocations.<sup>217</sup>

There are still differences in the degree of flexibility given by concessions and stock sales in relation to investment choices. With concessions, any material change to an infrastructure asset is subject to government approval to ensure that the intended functions of infrastructure are maintained.<sup>218</sup> This points to the format's current use in the "as-is" operation of existing assets.<sup>219</sup> The practice is common across all asset classes of infrastructure, including airports, toll roads, and power stations.<sup>220</sup> The approval requirement is fundamental to the predictability of future cash flows, but it is also a constraint on the growth of concessionaires.<sup>221</sup> Similarly, concessionaire SPVs for individual infrastructure assets are restricted from investing in other businesses, in order that the former to be unaffected by any failures in the latter.<sup>222</sup> Instead, their sponsors are allowed to own and operate multiple SPVs for individual infrastructure assets under one umbrella, and thereby pursue growth in parallel with specific ones.<sup>223</sup>

This constraint is less severe in the case of stock sales, where privatized infrastructure companies have more flexibility. One result is differences in the growth trajectories of privatized companies.<sup>224</sup> A case in point is Japan Railway Kyushu ("JR Kyushu"), which was

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<sup>216</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, YOBŌ-HOZEN NI YORU MENTENANSU ENO TENKAN NI TSUITE [ON THE CONVERSION TO MAINTENANCE BY PREVENTION] (Dec. 3, 2020), <https://www.mlit.go.jp/policy/shin-gikai/content/001375673.pdf> [<https://perma.cc/DVD5-ZSYZ>].

<sup>217</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KOKUDO-KŌTSŪ HAKUSHO 2014 [WHITE PAPER ON LAND, INFRASTRUCTURE, TRANSPORT AND TOURISM 2014] 77-78, [https://www.mlit.go.jp/hakusyo/89\\_ilt/h25/hakusho/h26/pdf/np102000.pdf](https://www.mlit.go.jp/hakusyo/89_ilt/h25/hakusho/h26/pdf/np102000.pdf) [<https://perma.cc/FE3L-V9Y2>] (last visited Nov. 1, 2022) (Japan).

<sup>218</sup> CONTRACT, *supra* note 54, at art. 40.

<sup>219</sup> *Id.*

<sup>220</sup> PFI Act, *supra* note 7, at art. 2(6); *see e.g.*, AICHI PREFECTURAL ROAD PUBLIC CORPORATION, *supra* note 153, at ch. 3-4; TOTTORI PREFECTURE, TOKUTEI JIGYŌ KEIYAKU NO OMONA NAIYŌ NI TSUITE [ON THE CONCESSION CONTRACT] ch. 5 (2020), <https://www.pref.tottori.lg.jp/secure/1215196/contract.pdf> [<https://perma.cc/ZLC3-DZ85>] (Japan).

<sup>221</sup> CONTRACT, *supra* note 54.

<sup>222</sup> *Id.* at art. 26.

<sup>223</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1(7).

<sup>224</sup> Asaoka & Sugimura, *supra* note 192, at 22.

privatized in 2016.<sup>225</sup> After the government sold all its stock in the company, JR Kyushu no longer needed the government's approval to enter into new businesses.<sup>226</sup> Thus, it gained the flexibility to make investment decisions, a prerequisite for accelerating its growth in non-railway businesses as a means of improving profitability.<sup>227</sup> While infrastructure privatized through stock sales is still regulated through such industry-specific laws as the Railway Business Act, Civil Aeronautics Act, Airport Act, and Telecommunications Business Act, these regulations apply equally to all firms in the industry concerned, whether government-owned or private.<sup>228</sup>

Further, concessions have an inherent underinvestment problem in relation to capital expenditures.<sup>229</sup> Being unable to enjoy financial returns from their capital investments after the end of the operating period, concessionaires have little incentive to make additional investments as the period draws to a close.<sup>230</sup> They prefer to make investments upfront, early in the operating period, and to restrain them later for a full recovery before the end of the period.<sup>231</sup> To mitigate the underinvestment problem, concession contracts typically include arrangements allowing operators to recoup their investments at the end of the operating period by selling their assets at fair value to the government or the next concessionaire.<sup>232</sup> However, assets eligible for such arrangements are limited to tangible ones that can be recorded on a balance sheet, such as buildings and equipment, and exclude intangibles such as investments in human capital or research and development.<sup>233</sup> Many aspects of infrastructure assets have intangible value, as seen in developments in technology to predict and manage demand

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<sup>225</sup> *Id.* at 16.

<sup>226</sup> *Id.* at 19.

<sup>227</sup> *Id.* at 20.

<sup>228</sup> Tetsudō Jigyō-hō [Railway Business Act], Law No. 9 of 1986, art. 2; Kōkū-hō [Civil Aeronautics Act], Law No. 231 of 1952, art. 2; Kūkō-hō [Airport Act], Law No. 80 of 1956, art. 2; Denki Tsūshin Jigyō-hō [Telecommunications Business Act], Law No. 86 of 1984, art. 2 (Japan).

<sup>229</sup> Claude Crampes & Antonio Estache, *Regulatory Trade-Offs in the Design of Concession Contracts*, 7 UTILS. POL'Y 1, 1 (1998).

<sup>230</sup> *Balanced Concessions for the Airport Industry: Delivering Win-Win Outcome for Successful Airport Concession Contracts* 28, IATA, <https://www.iata.org/contentassets/4eae6e82b7b948b58370eb6413bd8d88/balanced-concession-for-the-airport-industry.pdf> [<https://perma.cc/3EGR-RMDY>] (last visited Nov. 1, 2022) (Japan).

<sup>231</sup> *Id.*

<sup>232</sup> CONTRACT, *supra* note 54, at art. 64.

<sup>233</sup> *Id.*



for energy or transportation.<sup>234</sup> Similarly, the capacity to design sophisticated interfaces with users has translated into consistently high rankings for the amenities and usability of Japanese airports.<sup>235</sup> Investments in intangible assets are an essential part of building and sustaining an increasingly “smart” infrastructure. Concessionaires face the risk that investments in those fields may not be recovered because of the lack of such an arrangement. Even if one exists, there may be uncertainty concerning the valuation of those intangibles.

In contrast, stock sales do not have an underinvestment problem, because the investment period for the privatized enterprise is infinite under the assumption of a going concern.<sup>236</sup> This gives listed companies more flexibility in making capital investments than would be possible when an asset is under concession.<sup>237</sup> Infrastructure companies, which have privatized through stock sales, have invested in expanding their business base to meet shareholder expectations.<sup>238</sup> Major railway companies privatized from the 1980s through the 1990s have diversified by developing commercial and residential buildings along their railway lines.<sup>239</sup> Passengers buy groceries and clothing at retail outlets, dine at restaurants, and reside in houses and apartments, all of which are owned by railway companies and their subsidiaries.<sup>240</sup> Indeed, real estate is a major component of their business, even larger than railways themselves.<sup>241</sup> This diversified expansion is only made possible by having an infinite management period in which to pursue growth.<sup>242</sup>

Japan’s telecommunication giant, Nippon Telegraph and Telephone (“NTT”), has also diversified into mobile phones, data communication, and real estate since its listing in 1985.<sup>243</sup> Its mobile phone

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<sup>234</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, ARATANA JIDAI O KIZUKU JIZOKU KANŌ DE SHITSU NO TAKAI SHAKAI-SHIHON SEIBI [SUSTAINABLE AND HIGH-QUALITY INFRASTRUCTURE FOR THE NEW ERA] (Aug. 21, 2020), <https://www.mlit.go.jp/policy/shingikai/content/001359594.pdf> [<https://perma.cc/8C53-C8CS>] (Japan).

<sup>235</sup> See, e.g., *The World’s Top 10 Airports of 2022*, SKYTRAX: WORLD AIRPORT AWARDS, <https://www.worldairportawards.com/the-worlds-top-10-airports-of-2022/> [<https://perma.cc/W72N-XVHZ>] (last visited Sept. 24, 2022).

<sup>236</sup> BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89, at 6.

<sup>237</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1(10).

<sup>238</sup> Asaoka & Sugimura, *supra* note 192, at 22.

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> *NTT Group History*, NTT CORP., <https://www.global.ntt/our-history.html> [<https://perma.cc/M3PH-7497>] (last visited Nov 16, 2022).

subsidiary, NTT DoCoMo, listed in 1998 with the parent maintaining a majority, grew into the leader of Japan's mobile market.<sup>244</sup> In 2020, the subsidiary was delisted as the parent made it a wholly owned subsidiary at a valuation of \$36 billion (4.25 trillion yen), the largest tender offer in the country.<sup>245</sup> Similarly, electric power companies were listed as early as 1951 after the split of a nationwide electric firm into nine regional companies under a decree intended to unwind a concentration of power in the industry.<sup>246</sup> The regional firms have diversified over decades into businesses such as telecommunications, real estate, and construction.<sup>247</sup> Although excessive diversification in unrelated areas may cause a conglomerate discount,<sup>248</sup> it may also prompt the growth of new businesses, possibly leading to a premium instead.<sup>249</sup> For the privatized companies, these expansion initiatives have been possible only with the stock sale format, which places few restrictions on the scope of their business.<sup>250</sup>

This kind of flexibility may bring expectations for the growth of future cash flows.<sup>251</sup> In the above example of a stock sale, the value can be improved from  $100/.08$ , or 1,250, to  $100/(\.08 - g)$ , where  $g$  denotes the expected growth rate of future cash flows.<sup>252</sup> While the same can happen with a concession as demand for its services increases, a stock sale may raise expectations to a higher level provided

<sup>244</sup> *Id.*

<sup>245</sup> *Kabuiski-gaisha NTT Dokomo Kabushiki-tō (Shōken-kōdo 9437) ni Taisuru Kōkai Kaitsuke no Kekka ni Kansuru Oshirase [Results of a Takeover Bid for NTT DoCoMo (Securities Code 9437)]*, NIPPON TEL. & TEL. CORP. (Nov. 17, 2020), <https://group.ntt.jp/newsrelease/2020/11/17/pdf/201117a/201117a.pdf> [<https://perma.cc/TKZ3-ZUYY>] (Japan); Grace Huang & Gearoid Reidy, *NTT to Take Mobile Unit Docomo Private for \$38 billion*, BLOOMBERG (Sept. 29, 2020), <https://www.bloomberg.com/news/articles/2020-09-28/ntt-to-take-mobile-unit-docomo-private-for-38b-nikkei-reports> [<https://perma.cc/3LE8-ELUV>].

<sup>246</sup> *Order to Reorganize the Electric Power Business*, NAT'L ARCHIVES OF JAPAN (Nov. 24, 1950), <https://www.digital.archives.go.jp/DAS/meta/listPhoto?LANG=default&ID=F0000000000000105246&ID=&TYPE=> [<https://perma.cc/6PGE-55FC>] (Japan).

<sup>247</sup> *History*, TOKYO ELECTRIC POWER CO. HOLDINGS (May 2017), <https://www.tepco.co.jp/en/hd/about/corporate/history-e.html> [<https://perma.cc/P8JA-QHPM>].

<sup>248</sup> Larry H. P. Lang & René M. Stulz, *Tobin's q, Corporate Diversification, and Firm Performance*, 102 J. POL. ECON. 1248 (1994); Philip G. Berger & Eli Ofek, *Diversification's Effect on Firm Value*, 37 J. FIN. ECON. 39 (1995).

<sup>249</sup> See generally Belen Villalonga, *Diversification Discount or Premium? New Evidence from the Business Information Tracking Series*, 59 J. FIN. 479 (2004).

<sup>250</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1(10).

<sup>251</sup> See *supra* Part III(B).

<sup>252</sup> *Id.*

that growth outside a given asset is feasible and is reflected in the growth rate.<sup>253</sup> However, such expectations may be partly offset by the higher risk associated with such expansion, which results in a higher discount rate.<sup>254</sup>

Given these differences, it is necessary for the government to make tradeoffs between stability and flexibility.<sup>255</sup> While concessions bring the government more proceeds as well as more control over privatized assets, stock sales give privatized companies greater long-term flexibility in developing their own strategies.<sup>256</sup> Stock sales likely create more value for shareholders as well, as shareholders anticipate at the time of listing the stock.<sup>257</sup> Although concessions have been the dominant format since the 2010s across all sectors of transportation, energy, and water services, this may mean that the government is, in effect, prioritizing its own short-term proceeds rather than promoting the long-term growth of privatized companies and thereby the economy overall – in the end, a more important matter for the government itself.<sup>258</sup>

#### D. Ownership

The difference between the two formats regarding ownership of underlying infrastructure assets involves another difference, one that concerns restrictions placed on stock ownership. With a concession, underlying assets remain under government ownership, but in return, there is no restriction on the ownership of operating rights. This gives rise to clear differences in ownership by foreign investors.<sup>259</sup> For instance, Vinci of France owns a 40% stake in the SPV for the Kansai Airport concession, something which might not have been possible under a stock sale.<sup>260</sup> There was no major public backlash observed for this cross-border investment, as there had been for investments in Haneda Airport's terminal building company several years earlier.<sup>261</sup> This is an interesting twist, given that the concession format was a

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<sup>253</sup> See BREALEY, MYERS, ALLEN & EDMANS, *supra* note 89, at 98-99.

<sup>254</sup> *Id.*

<sup>255</sup> Daisuke Asaoka, *Infura Min'eika Shuhō to Kachi: Kabushiki Baikyaku to Konsesshon* [Privatization Methodology and the Value of Infrastructure: Stock Sales and Concessions] 31 JICPA J. 117, 122 (2018).

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> PROCEDURES, *supra* note 113 at V.

<sup>260</sup> See SELECTION, *supra* note 128.

<sup>261</sup> Fukuda, *supra* note 19.

response to a series of shareholder actions against listed infrastructure companies in the 2000s.<sup>262</sup> The apparent lack of opposition was partly because Vinci was a strategic investor with operating capabilities, as opposed to a financial investor, but mostly because the format puts the concessionaire in a contractual relationship with the government, the asset owner, for a finite timeframe.<sup>263</sup> In addition to giving both sides predictability, it essentially allows the government to experiment with the format by giving it the option to unwind the program after the operating period ends, should it perceive any drawbacks or public backlash.<sup>264</sup>

In contrast, stock sales result in a permanent transfer of ownership, with the government often setting legal restrictions on foreign ownership.<sup>265</sup> Under an amendment to FEFTA in 2019,<sup>266</sup> investments in 1% or more of the shares of firms in designated industries, including infrastructure sectors, became subject to government reporting requirements.<sup>267</sup> Based on its examination of the reports, the government has the authority to block an investment or request a change in its content.<sup>268</sup> Following a backlash from institutional investors, however, the government set broad exemptions to the regulation.<sup>269</sup> Specifically, it made passive investors exempt from such requirements, even strategic investors provided they had no access to the key technologies of an

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<sup>262</sup> *Id.*

<sup>263</sup> *See supra* Part II(D).

<sup>264</sup> *Id.*

<sup>265</sup> *Saikin no Gaitame-hō Kaisei [Recent Amendment of the Foreign Exchange and Foreign Trade Act]*, MINISTRY OF FIN. OF JAPAN, [https://www.mof.go.jp/international\\_policy/gaitame\\_kawase/gaitame/recent\\_revised/index.html](https://www.mof.go.jp/international_policy/gaitame_kawase/gaitame/recent_revised/index.html) [<https://perma.cc/7JU5-FE5J>] (last visited Sept. 24, 2021).

<sup>266</sup> *Id.*

<sup>267</sup> Designated sectors include weapons, aircraft, nuclear facilities, space, dual-use technologies, cybersecurity, electricity, gas, telecommunications, water supply, railways, oil, heat supply, broadcasting, public transportation, biological chemicals, security services, agriculture, forestry and fisheries, leather manufacture, air transportation, and maritime transportation. *See Amendment of the Ministerial Ordinance and Notice for the Foreign Exchange and Foreign Trade Act*, MINISTRY OF FIN. OF JAPAN (Mar. 25, 2020), [https://www.mof.go.jp/policy/international\\_policy/gaitame\\_kawase/press\\_release/kanrenshiryō\\_20200325.pdf](https://www.mof.go.jp/policy/international_policy/gaitame_kawase/press_release/kanrenshiryō_20200325.pdf) [<https://perma.cc/N559-B3FK>]; *see also* Yosuke Higashi, *Ministerial Ordinance and Notice for the Amended Foreign Exchange and Foreign Trade Act*, 32 MORI HAMADA & MATSUMOTO CORP. NEWSL. 1 (Mar. 2020), [https://www.mhmjapan.com/content/files/00041588/CORPORATE%20NEWSLETTER%20\(Vol.32\).pdf](https://www.mhmjapan.com/content/files/00041588/CORPORATE%20NEWSLETTER%20(Vol.32).pdf) [<https://perma.cc/V4BB-NCGY>].

<sup>268</sup> MINISTRY OF FIN. OF JAPAN, *supra* note 265.

<sup>269</sup> *Id.*

investee firm or a seat on its board.<sup>270</sup> In 2021, there were 2,859 such reports submitted and none were blocked.<sup>271</sup> However, an investment in 2021 by the Chinese firm Tencent, in 3.65% of the shares of Rakuten, a Japanese e-commerce platformer, was criticized as having utilized a regulatory loophole which exempted Tencent from the reporting obligations based on their explanation that the firm would not access Rakuten's key technologies or sit on its board.<sup>272</sup>

Other than FEFTA, there are a number of laws that categorically limit foreign ownership in certain industries. Under a law specifically applied to NTT, for example, foreign ownership in the telecommunications giant is limited to a third.<sup>273</sup> The government further obliges itself to keep a third or more of the company's shares.<sup>274</sup> Such foreign ownership restrictions are also seen in other key industries. Foreign ownership of airliners and freight forwarders is limited to a third of shares,<sup>275</sup> and in broadcasters and the Japan Exchange Group, the country's largest stock exchange, to a fifth.<sup>276</sup> Such regulations may not have been strictly enforced, though: in 2021, Fuji Media Holdings, one of the major Japanese broadcasters, and its supervisor, the Ministry of Internal Affairs and Telecommunications, were blamed for failing to disclose that the former had violated the regulation by temporarily allowing its foreign ownership to exceed a fifth, from 20.00042% to 20.00083%, between 2012 and 2014, which the company attributed to mistakes in calculating the ownership percentage.<sup>277</sup>

<sup>270</sup> *Id.*

<sup>271</sup> *Tainai Chokusetsu Tōshi-tō ni Kansuru Jizen Todokede Kensū-tō ni Tsuite (Reiwa 3-nendo/2021-nendo-ban)* [Regarding the Number of Advance Notifications, etc. on Inward Direct Investment, etc. (Fiscal Year 2021 version)], MINISTRY OF FIN. OF JAPAN (June 2022), [https://www.mof.go.jp/policy/international\\_policy/gaitame\\_kawase/press\\_release/20220610.pdf](https://www.mof.go.jp/policy/international_policy/gaitame_kawase/press_release/20220610.pdf) [<https://perma.cc/VUX2-6XLD>] (Japan).

<sup>272</sup> See *Kaisei Gaitamehō, Jizen Shinsa Manugare Chūgoku Tensento no Rakuten Shusshi* [Revised Foreign Exchange Act Exempts from Pre-examination Rakuten Investment by Ch'na's Tencent], NIKKEI (Apr. 20, 2021, 5:38 AM), <https://www.nikkei.com/article/DGXZQOUA0781S0X00C21A4000000/?unlock=1> [<https://perma.cc/TDL9-GL3X>] (Japan).

<sup>273</sup> Nippon Denshin Denwa-hō [Nippon Telegraph and Telephone Act], Law No. 85 of 1984, art. 6 (Japan).

<sup>274</sup> *Id.* at art. 4.

<sup>275</sup> Kōkū-hō [Aviation Act], Law No. 231 of 1952, art. 120-2 (Japan); Kamotsu Riyō Unsō Jigyō-hō [Consigned Freight Forwarding Business Act], Law No. 82 of 1989, art. 6(v) (Japan).

<sup>276</sup> Hōsō-hō [Broadcast Act], Law No. 132 of 1950, arts. 93(1)(vi), 159(2)(v) (Japan); Denpa-hō [Radio Act], Law No. 131 of 1950, art. 5(4) (Japan).

<sup>277</sup> See *Fuji HD Gaishi Kisei Ihan Mitomeru Sōmushō ni 14-nen Hokoku* [Fuji HD Admits Violation of Broadcast Law, Violation Reported to the Ministry of Internal Affairs and Telecommunication in 2014], NIKKEI (Apr. 9, 2021, 5:13 AM),

Although the ministry should have repealed Fuji Media's broadcasting license for violating the law,<sup>278</sup> it did not because the company notified the ministry after correcting the breach itself.<sup>279</sup> This naturally led to the law's amendment to widen the scope of timely disclosure on ownership by licensed broadcasters.<sup>280</sup>

In contrast, railway companies have no regulation other than the FEFTA requirement that limits foreign ownership in the industry.<sup>281</sup> The absence is perhaps a reflection of the decision to split and privatize the former nationwide railway company as an antidote to the myriad labor disputes that occurred under government ownership, which made the government reluctant to retain any ownership but willing to let investors own the split-up companies.<sup>282</sup> In line with the absence of regulations, both the government and the public have seemed rather accommodating to the listing of JR Kyushu, and, unlike in the 2000s, even to the shareholder activism directed toward the company.<sup>283</sup> That may also reflect change in perceptions toward activism that accompanied the introduction of the Japanese stewardship code in 2014<sup>284</sup> and the corporate governance code in 2015<sup>285</sup> as part of the corporate governance reforms introduced by the Abe administration. Similarly, there is no specific restriction on the ownership of electric power companies, again except for FEFTA.<sup>286</sup> This also reflects their origin in the

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<https://www.nikkei.com/article/DGXZQOUC086L00Y1A400C2000000/>  
[<https://perma.cc/57AB-MFCP>].

<sup>278</sup> See Broadcast Act, *supra* note 276.

<sup>279</sup> Press Release, Ministry of Internal Affairs & Communications, Takeda Sōmu Daijin Kakugi-go Kisha-kaiken no gaiyō [Overview of the Post-Cabinet Press Conference by Minister for Internal Affairs and Communications Takeda] (Apr. 6, 2021), [https://www.soumu.go.jp/menu\\_news/kaiken/01koho01\\_02001009.html](https://www.soumu.go.jp/menu_news/kaiken/01koho01_02001009.html) [<https://perma.cc/29UY-6D48>] (Japan).

<sup>280</sup> Shinji Akiyama, Tomohiro Takeda, Hirokane Enoki, Yuki Motomura, Tomoyuki Honda, Satoshi Tojo & Shoichi Iwatsubo, *On the Act to Partially Amend the Radio Act and the Broadcasting Act*, 6 J. INFO. & COMM'NS POL'Y IV-1 (Aug. 5, 2022), [https://www.soumu.go.jp/main\\_content/000828892.pdf](https://www.soumu.go.jp/main_content/000828892.pdf) [<https://perma.cc/VH57-2LC3>].

<sup>281</sup> Tetsudō Jigyō-hō [Railway Business Act], Law No. 9 of 1986, art. 3.

<sup>282</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, *supra* note 187.

<sup>283</sup> JAPAN RY. KYUSHU, *supra* note 193.

<sup>284</sup> *Principles for Responsible Institutional Investors <<Japan's Stewardship Code>> - To Promote Sustainable Growth of Companies Through Investment and Dialogue (FY2019)*, THE COUNCIL OF EXPERTS ON THE STEWARDSHIP CODE (Mar. 24, 2020), <https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/01.pdf> [<https://perma.cc/3A49-M2L6>].

<sup>285</sup> See TOKYO STOCK EXCH., *supra* note 169.

<sup>286</sup> Gaikoku Kawase oyobi Gaikoku Bōekihō [Foreign Exchange and Foreign Trade Act], Law No. 228 of 1949, art. 27(5) (Japan).

splitting, in 1951, of a government-controlled power company into nine private regional ones.<sup>287</sup> These examples show that ownership regulations are not an a priori policy proposition, but a reflection of multiple factors that include the industry's path-dependent growth trajectory.

### E. *Liquidity*

When a stock sale is conducted through an IPO, investors enjoy the liquidity of shares listed on the stock exchange.<sup>288</sup> In contrast, concessions provide only limited liquidity since stocks of concessionaire SPVs are unlisted and the transfer of their ownership requires government approval.<sup>289</sup> The approval requirement exists because of the lack of human capital in concessionaire SPVs, at least when arranging concessions, and the possibility that a transfer of ownership will affect the concessionaire's operating capability.<sup>290</sup> The concession format involves replacing the government officials who would otherwise operate the infrastructure with employees of the concessionaire.<sup>291</sup> For this reason, the government requires operating capability at the level of sponsors, who fill vacancies in human capital at the outset.<sup>292</sup>

For better liquidity of investments, the conditions required for government approval must be clearly defined in order that approval is not unreasonably withheld.<sup>293</sup> In practice, the terms of concessions stipulate that the government must approve the transfer of ownership unless operations are not hindered by the transfer.<sup>294</sup> However, given its emphasis on the operating capability of concessionaires following the replacement of public officials, the government may still prefer a candidate willing to hold a stake in a concessionaire SPV over the long term to one planning to sell it down immediately after being selected.<sup>295</sup>

This stands in contrast to stock sales, where companies already have operating capabilities at the firm level.<sup>296</sup> When corporatization

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<sup>287</sup> See NAT'L ARCHIVES OF JAPAN, *supra* note 246.

<sup>288</sup> Asaoka, *supra* note 255.

<sup>289</sup> IMPLEMENTATION POLICY, *supra* note 46, at IV-4-2.

<sup>290</sup> Asaoka, *supra* note 255.

<sup>291</sup> *Id.*

<sup>292</sup> *Id.*

<sup>293</sup> IMPLEMENTATION POLICY, *supra* note 46, at IV-4-2.

<sup>294</sup> *Id.*

<sup>295</sup> *Id.*

<sup>296</sup> Asaoka, *supra* note 255.

is followed by a stock sale, it is often the case that former government officials become employees of a corporation wholly owned by the government. In this capacity, they maintain the company's operations, the change in ownership at the shareholder level having no effect on operations at the company level.<sup>297</sup> While a concession-led transition from government to private operation can be complemented by the secondment of government officials for up to five years at the concessionaire's request, as is possible under the PFI Act,<sup>298</sup> support from the concessionaire's sponsors is essential in the early phases.<sup>299</sup> A decrease in sponsor ownership may negatively affect operations, forcing a tradeoff with the benefits of the liquidity provided by the investments.

The requirement that operating capability be tied to ownership also hinders participation by institutional investors. For their investments, the use of non-voting stock is listed by the government as an example of a class of stock that an SPV can issue for institutional investors while voting stock is held by sponsors.<sup>300</sup> If financial investors are only seeking economic returns from an infrastructure asset, this class of non-voting stock may work. However, given that institutional investors are increasingly expected to influence investees by exercising voting rights under the stewardship code introduced in 2014,<sup>301</sup> non-voting shares are adopted only rarely. Preferred stock issued by Ito-En Co., Japan's top producer of green tea, is the only example of listed non-voting shares in Japan.<sup>302</sup> Reflecting its unpopularity among investors, the share price of the company's non-voting preferred stock is just about a third of the price of a voting share, despite its preferred dividend being set at 125% of the price of the voting share.<sup>303</sup>

Therefore, a structure is still needed to make prospective concessionaires commit to continued operations while having the freedom to liquidate at least part of their financial investment, just as a corporation allows for the separation of management and ownership. A possible

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<sup>297</sup> *Id.*

<sup>298</sup> PFI Act, *supra* note 7, at arts. 22(1)(iv), 78-79.

<sup>299</sup> SENDAI INT'L AIRPORT CO., *supra* note 69.

<sup>300</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-2-6.

<sup>301</sup> *See* COUNCIL OF EXPERTS ON THE STEWARDSHIP CODE, *supra* note 284.

<sup>302</sup> *Shinki-jōjō Meigara Gaiyō* [*The Summary of the Initial Public Offering Stock*], TOKYO STOCK EXCH., <https://www.jpx.co.jp/equities/products/preferred-stocks/issues/tvdivq000007usm-att/25935g.pdf> [<https://perma.cc/AF44-49YY>] (last visited Aug. 12, 2021).

<sup>303</sup> *Id.*



solution would be to promote the use of limited partnerships, as discussed in Part IV.<sup>304</sup>

It is likely, however, that concessionaire SPVs will accumulate human capital over the years and achieve sufficient operating capability on their own. In such a scenario, there will be no need for operating capability at the sponsor level, and the concession format will become similar to a stock sale, in which operating capability is already embedded within the infrastructure assets. Likewise, the bidding process for concessions will be more like a competition over closely held stock sales, with improved liquidity provided.

#### F. *Governance*

Governance structure also differs between the two formats.<sup>305</sup> In a stock sale, the government, lacking ownership, regulates privatized companies only within the purview of laws and regulations applied equally within the industry concerned.<sup>306</sup> In addition to government regulation, companies privatized by stock sales are subject to provisions of the corporate governance code applied to listed companies, covering matters ranging from board independence and diversity to compensation policy and internal controls.<sup>307</sup> They must deal with general shareholders in the public markets as well, including not only active investors but passive ones, the latter being increasingly willing to exercise their voting rights and voice their concerns under the Japanese stewardship code.<sup>308</sup> Under Japanese corporate law, the shareholders of listed companies are entitled to wide-ranging proxy access.<sup>309</sup> A shareholder having a 1% stake in a company for at least six months is entitled to submit proposals for voting at a shareholders' meeting at the company's cost.<sup>310</sup> There is no limit on the scope of such proposals unless the same ones have been rejected for the past three years with an approval rate of 10% or less.<sup>311</sup> A shareholder can thus include various agendas, including the appointment of directors, payment of dividends, and divestment of assets.

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<sup>304</sup> See *infra* Part IV(B).

<sup>305</sup> Asaoka, *supra* note 255.

<sup>306</sup> *Id.*

<sup>307</sup> TOKYO STOCK EXCH., *supra* note 169.

<sup>308</sup> THE COUNCIL OF EXPERTS ON THE STEWARDSHIP CODE, *supra* note 284.

<sup>309</sup> See Kaisha-hō [Companies Act], Law No. 86 of 2005, arts. 303(2), 305(1) (Japan).

<sup>310</sup> *Id.*

<sup>311</sup> *Id.* at art. 304.

Even when conducting a stock sale, the government can have wider discretion if the sale is only partial, in which case it will have influence as a major shareholder as well as a supervisory authority. The practice of cross-shareholding is persistent in the Japanese market, but it is also noteworthy that stock ownership per shareholder is dispersed at a level equivalent to that of the U.S. and the U.K. when measured by the ownership concentration of the top three shareholders.<sup>312</sup> This gives the government shareholder power without competing block holders. A significant level of government ownership under this dispersed ownership structure would give the government exceptional influence, possibly even with less of an incentive to increase the equity value of the privatized company than general shareholders, in addition to the authority to approve the appointment of board directors, articles of incorporation, annual management plans, new share issues, and sales of key assets.<sup>313</sup> Such influence could give the managers of a privatized company an incentive to build a close relationship with the government, since it is the government, as opposed to the collective will of public investors, that has the key say in management decisions. Such a joint ownership structure could hinder the growth of the company's value and lead instead to its stagnation.

With a concession, the government may be the owner of the underlying assets, but the transparency and clarity of its authority as a party to the contract serve to curb its discretion.<sup>314</sup> Since a concessionaire SPV is privately owned by sponsors in a consortium, it is not subject to the governance requirements for listed firms, and the sponsors' public shareholders have only an indirect say in the course of the privately held vehicle.<sup>315</sup> While the vehicle has autonomy in that financial risks and rewards are transferred to the private sector, the monitoring role of the government is important in ensuring that required standards are established, including that concessionaires may be replaced in the event of a material breach of a contract.<sup>316</sup> Such monitoring is indispensable to securing the public's interest in infrastructure under a concession.<sup>317</sup> Here, there is a social shift toward faith in contracts and

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<sup>312</sup> Gur Aminadav & Elias Papaioannou, *Corporate Control Around the World*, 75 J. FIN. 1191, Table 1 (2020).

<sup>313</sup> See, e.g., Nippon Denshin Denwa-hō [Nippon Telegraph and Telephone Act], Law No. 85 of 1984, arts. 4 (stock issuance), 10 (board appointment), 11 (articles of incorporation), 12 (annual management plan), 14 (asset sales) (Japan).

<sup>314</sup> See generally CONTRACT, *supra* 54.

<sup>315</sup> TOKYO STOCK EXCH., *supra* note 169.

<sup>316</sup> CONTRACT, *supra* note 54, at art. 68.

<sup>317</sup> *Id.* at art. 52.

their enforcement under the rule of law, rather than in ambiguous relationships with the government.<sup>318</sup>

### G. *Equal Footing*

As a corollary to the flexibility provided by stock sales, government regulation requires additional consideration as to the competitive environment of the market.<sup>319</sup> A prime example is equal footing accorded to all competitors in an industry.<sup>320</sup> It is often the case for a privatized company to have a monopolistic or oligopolistic position in its market. Regulations matter here to ensure that competitors and new entrants are given equal footing.<sup>321</sup>

Electric power companies, for instance, have a regional monopoly on the transmission lines connecting power producers with end users.<sup>322</sup> The discussion on fair access gained importance with the progress of deregulation.<sup>323</sup> Entry by wholesale power producers was allowed in 1995, and by retail power producers in a gradual process from 2000 to 2016.<sup>324</sup> Deregulation accelerated after the 2011 disaster at the Fukushima nuclear power plant, as criticism surged against the inertia of Tokyo Electric Power Co., the regional monopoly for Fukushima and the rest of the country's northeastern region.<sup>325</sup> Deregulation caused the incumbent power companies to lose their regional monopolies in both the wholesale and retail power markets, although as of 2021 they still maintained a market share of 80% in total.<sup>326</sup> Their competitors' access to the transmission lines was improved in 2020 by carveouts of regional transmission line businesses into either

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<sup>318</sup> *Id.*

<sup>319</sup> Asaoka, *supra* note 255.

<sup>320</sup> Koichi Hirohara, *Denryoku no Zenmen Jiyūka* [Full Deregulation of Electric Power], 377 RIPPŌ TO CHŌSA [LEGISLATION AND RESEARCH] 2 (2016) (Japan).

<sup>321</sup> *Id.*

<sup>322</sup> *Id.*

<sup>323</sup> *Id.*

<sup>324</sup> MINISTRY OF ECON., TRADE & INDUS., DENRYOKU SHISUTEMU KAIKAKU SENMON IINKAI HŌKOKUSHO [ELECTRICITY SYSTEM REFORM EXPERT COMMITTEE REPORT] (Feb. 2013), [https://www.meti.go.jp/shingikai/enecho/kihon\\_seisaku/denryoku\\_system/seido\\_sekkei/pdf/01\\_s01\\_00.pdf](https://www.meti.go.jp/shingikai/enecho/kihon_seisaku/denryoku_system/seido_sekkei/pdf/01_s01_00.pdf) [<https://perma.cc/G9UB-UFZL>] (Japan).

<sup>325</sup> *Id.*

<sup>326</sup> MINISTRY OF ECON., TRADE & INDUS., DENRYOKU GASU KOURI ZENMEN JIYŪKA NO SHINCHOKU JŌKYŌ NI TSUITE [PROGRESS OF THE FULL LIBERALIZATION OF THE ELECTRICITY AND GAS RETAIL MARKET] (Apr. 28, 2021), [https://www.meti.go.jp/shingikai/enecho/denryoku\\_gas/denryoku\\_gas/pdf/034\\_03\\_00.pdf](https://www.meti.go.jp/shingikai/enecho/denryoku_gas/denryoku_gas/pdf/034_03_00.pdf) [<https://perma.cc/ATB8-QP8L>] (Japan).

subsidiary of each regional electric power company or a sister company under the same corporate umbrella.<sup>327</sup> However, the incumbents' full capital ties to the carved-out entities remains a hindrance to fair competition. A spin-off of the subsidiaries would be necessary to create a level playing field, one where transmission line businesses are owned by general shareholders in the public markets and the transmission lines are independent of the incumbents.<sup>328</sup>

Such competition issues are also apparent in the privatization of Japan Post Holdings and its subsidiaries, Japan Post, Japan Post Bank, and Japan Post Insurance. In addition to an authorized monopoly on mail delivery, Japan Post has an oligopolistic position in package delivery services with a third-place share of 22.5%.<sup>329</sup> Japan Post Bank has a dominant position in retail banking as well, with the top share of 27.7% in retail deposits.<sup>330</sup> Japan Post Insurance also holds the third position, with a share of 16.3%, in terms of life insurance premium revenues.<sup>331</sup> Given its strong position in each segment of its wide range of services, its competitors are naturally cautious about the group's moves under the government's gradual sale of its holdings under ongoing privatization.<sup>332</sup> One focal regulation has been that which limits the number of deposits that Japan Post Bank may accept per customer to \$210,000 (26 million yen)<sup>333</sup> while imposing no such limit on deposits for commercial banks. The limit exists because, with the government's controlling ownership, deposits at the postal bank are

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<sup>327</sup> MINISTRY OF ECON., TRADE & INDUS., HŌTEKI BUNRI (2020-NEN 4-GATSU 1-NICHI) IKŌ NO KAKUSHA NO JIGYŌ KEITAI [BUSINESS STRUCTURE OF EACH COMPANY AFTER LEGAL UNBUNDLING (APR. 1, 2020)] (2019), <https://www.meti.go.jp/press/2019/03/20200313008/20200313008-1.pdf> [<https://perma.cc/6G6S-2BAT>] (Japan).

<sup>328</sup> Koichiro Ito, *Keitō'un'yō, Kōteki Kikan e Ikō o Hassō-den Bunri no Kadai* [Grid Operation, Transition to Public Institutions Issues in Separating Power Generation and Transmission], RSCH. INST. OF ECON., TRADE & INDUS. (Apr. 15, 2020), <https://www.rieti.go.jp/papers/contribution/ito-koichiro/05.html> [<https://perma.cc/U27W-79AV>] (Japan).

<sup>329</sup> MINISTRY OF INTERNAL AFFS. & COMMC'NS, *supra* note 177, at 30.

<sup>330</sup> *Id.* at 31.

<sup>331</sup> *Id.*

<sup>332</sup> *Yūcho Gink no Shinki Gyōmu ni Kakaru Ninka Shinsei ni Tsuite* [On the Application for Approval for New Businesses by Japan Post Bank], ZENKOKU GINKO KYOKAI (JAPANESE BANKERS ASSOCIATION) (Dec. 3, 2021), <https://www.zenginkyo.or.jp/news/2021/n120301/> [<https://perma.cc/3P4E-KCYN>] (Japan).

<sup>333</sup> *Yūsei Min'eika-hō Sekō-rei* [Order for Enforcement of the Postal Service Privatization Act], Order No. 342 of 2005, art. 2(2)(i) (Japan).

deemed to be backed by an implicit government guarantee,<sup>334</sup> which exceeds the amount of the deposit insurance of \$80,000 (10 million yen) provided for deposits at commercial banks.<sup>335</sup> Given that Japan Post Bank has the top share in deposits, the ceiling requires a balanced effort to smoothly privatize the bank while making competition work on equal footing.<sup>336</sup>

Meanwhile, Japan Post Holdings and its wholly-owned subsidiary, Japan Post, have a universal service obligation under which they are required to keep outposts for postal services available throughout the country.<sup>337</sup> These facilities are shared to provide the banking and insurance services of Japan Post Bank, and Japan Post Insurance. This does not mean that services are maintained at the same level as before privatization.<sup>338</sup> In October 2021, amid the partial privatization, Japan Post Holdings and Japan Post stopped delivering regular mail on Saturdays in addition to Sundays and started to take two days, rather than one, to deliver regular mail.<sup>339</sup> This was in response to a surge in demand for package delivery that was intensified by the pandemic and exacerbated by a labor shortage.<sup>340</sup> Packages continue to be delivered seven days a week.<sup>341</sup> The apparent reduction in services is often attributed to the effects of privatization, as consumers tend to expect at least the same level of service they enjoyed before.<sup>342</sup> However,

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<sup>334</sup> *Yūcho Gendo-gaku, 2600-man-en ni Baizō Kakugi Kettei [Cabinet Decision] Cabinet Decision To Double Postal Savings Limit To 26 Million Yen*, NIKKEI (Mar. 8, 2019), <https://www.nikkei.com/article/DGXMZO42145900X00C19A3EAF000/> [<https://perma.cc/G7CM-7QK5>] (Japan).

<sup>335</sup> *Mangaichi 'in'yū-kan ga Hatan Shita Toki [When a Financial Institution Goes Bankrupt]*, DEPOSIT INS. CORP. JAPAN, [https://www.dic.go.jp/yokinsha/page\\_000134.html](https://www.dic.go.jp/yokinsha/page_000134.html) [<https://perma.cc/QZ9R-HVZQ>] (last visited Sept. 24, 2022) (Japan).

<sup>336</sup> ZENKOKU GINKO KYOKAI (JAPANESE BANKERS ASSOCIATION), *supra* note 332.

<sup>337</sup> *Yūsei 'in'eika-hō [Postal Service Privatization Act]*, Law No. 97 of 2005, art. 7-2 (Japan); *Nippon Yūsei-hō [Act on Japan Post Holdings Company]*, Law No. 98 of 2005, art. 5(1) (Japan); *Nippon Yūbin-hō [Act on Japan Post Company]*, Law No. 100 of 2005, art. 5 (Japan).

<sup>338</sup> *Id.*

<sup>339</sup> *Nippon Yūbin ni Okeru Sābisu no Minaoshi [Review of the Services at Japan Post]*, MINISTRY OF INTERNAL AFFS. & COMM'NS (Sept. 17, 2021), [https://www.soumu.go.jp/menu\\_news/s-news/01ryutsu14\\_02000110.html](https://www.soumu.go.jp/menu_news/s-news/01ryutsu14_02000110.html) [<https://perma.cc/6ZX6-T7RR>] (last visited Sept. 24, 2022) (Japan).

<sup>340</sup> *Id.*

<sup>341</sup> *Id.*

<sup>342</sup> *Id.*

similar streamlining might have occurred even under government operation given the chronic labor shortages in the market.<sup>343</sup>

In contrast to the tight regulations imposed on stock sales to ensure equal footing, concessions are saddled with fewer such requirements in return for limits on the scope of their operations.<sup>344</sup> The government even provides concessionaires with a degree of protection against competition, typically by agreeing to compensate concessionaires for policy changes that would materially affect their competitive environment.<sup>345</sup> These might include the development of similar infrastructure in a nearby location or of a kind that affects only the concessionaire as opposed to all players in the industry.<sup>346</sup> In this sense, concessions can be viewed as privatization in a more controlled environment. However, in response to criticism that the limits on the operation were too restrictive and deprived concessionaires of reasonable opportunities for growth, the government started discussions in June 2021 on deregulation which would allow concessionaires to add new infrastructure assets to existing ones and otherwise expand their range of business.<sup>347</sup> These will likely lead to a discussion on equal footing as well, given that concessionaires still maintain a certain monopolistic power over the original assets while aiming for expansion.<sup>348</sup>

#### H. Regulation for Pricing

The monopolistic position of privatized companies makes pricing regulations critical, although privatized firms have basic discretion over the pricing of goods and services within both the stock sale and concession formats.<sup>349</sup> Such regulations exist because infrastructure assets, given their market position, can generally improve profitability by raising prices or slashing maintenance investment without affecting

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<sup>343</sup> *Id.*

<sup>344</sup> IMPLEMENTATION POLICY, *supra* note 46, at II-1(10).

<sup>345</sup> CONTRACT, *supra* note 54, at arts. 45, 62(2).

<sup>346</sup> *Id.*

<sup>347</sup> PPP/PFI *Suishin Akushon Puran (Reiwa 3-nen Kaiteiban)* [PPP/PFI Promotion Action Plan (Revised in 2021)], CABINET OFF. OF JAPAN (June 18, 2021), <https://www8.cao.go.jp/pfi/actionplan/pdf/actionplan2.pdf> [<https://perma.cc/YS6M-3CYL>] (Japan).

<sup>348</sup> ORG. FOR ECON. CO-OPERATION & DEV., COMPETITION POLICY AND CONCESSIONS, POLICY BRIEF (May 2007), <https://www.oecd.org/daf/competition/sectors/38706036.pdf> [<https://perma.cc/TA2J-2CCG>].

<sup>349</sup> PRINCIPLES, *supra* note 45, at II-8.

demand.<sup>350</sup> This would essentially be a transfer of wealth from users rather than an improvement in productivity.<sup>351</sup> For instance, the telecommunications industry is an oligopoly of the partially privatized NTT and its private competitors with limited availability of bandwidth and fiber optic cables, making the upper limit of their pricing subject to government approval.<sup>352</sup> Similarly, railway companies are regional monopolies or oligopolies comprising JR companies and their regional competitors and are subject to similar regulation.<sup>353</sup>

The caution against price hikes is more conspicuous in concessions than in stock sales, presumably because of the relatively narrow scope of privatized infrastructure users. Hamamatsu, a city in the central prefecture of Shizuoka, solicited concession candidates for its sewage services in 2018.<sup>354</sup> However, the selected concessionaire, whose investors included the French operator Veolia, faced a civic campaign by local residents concerned about a potential deterioration of water quality under private operation.<sup>355</sup> Price changes require approval by the city's assembly in this case and thus are kept under control,<sup>356</sup> but the residents were concerned about a typical strategy to improve profitability, namely rationalizing investments to reduce costs.<sup>357</sup> In 2019, in the face of this opposition, the municipal government indefinitely postponed a planned concession of its water supply service, originally set to follow the concession of its sewage service, and contracted with a third-party monitor to tighten monitoring of the concessionaire.<sup>358</sup> This may not be the harbinger of a general trend, however, as the northeastern Miyagi Prefecture, home to Sendai Airport, concluded in 2021 the concession contracts for both water supply

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<sup>350</sup> *Id.*

<sup>351</sup> *Id.*

<sup>352</sup> *Denki Tsūshin Jigyō-hō* [Telecommunications Business Act], Law No. 86 of 1984, arts. 21(1), 33(2) (Japan).

<sup>353</sup> *Tetsudō Jigyō-hō* [Railway Business Act], Law No. 92 of 1986, art. 16 (Japan).

<sup>354</sup> *Hamamatsu-shi Kōkyō Gesuidō Shumatsu-shorijo (Seien Shori-ku) Un'ei Jigyō* [Hamamatsu Public Sewage Treatment Plant (Seien Treatment Area) Operation Project], HAMAMATSU CITY (Feb. 1, 2021), <https://www.city.hamamatsu.shizuoka.jp/g-sisetu/gesui/seien/pfi.html> [<https://perma.cc/6EDR-YH2R>] (Japan).

<sup>355</sup> *Id.*

<sup>356</sup> *Id.*

<sup>357</sup> *Id.*

<sup>358</sup> *Id.*

and sewage services with a consortium led by Metawater, a Japanese water supplier, joined by Veolia.<sup>359</sup>

Most of the privatized airports carried excess capacity at the time of privatization, which means that lowering, rather than raising, prices has been a common strategy used to increase traffic and attendant consumption at retail outlets and restaurants in terminal buildings.<sup>360</sup> However, in some cases, including such major downtown airports as Itami Airport in Kansai and Fukuoka Airport, there has been a chronic excess of demand over supply, the pandemic period being an exception.<sup>361</sup> This enables concessionaires to improve profits merely by raising prices within the limits of laws restricting discriminatory or unreasonable pricing.<sup>362</sup> The possibility that concessionaires will raise prices for an infrastructure asset whose demand exceeds supply relates to the government's proceeds from selling the asset's operating rights, as well as the willingness of investors to participate in the competitive bidding process.<sup>363</sup> Thus, the government shares, to some extent, provide incentives to allow flexible price increases for the purpose of improving proceeds.<sup>364</sup> This again requires that the government strike a balance between securing investment opportunities for private capital in an effort to reduce public debt and protect the interests of public users by addressing perceived fairness in pricing before and after privatization.<sup>365</sup>

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<sup>359</sup> *Miyagi-ken Jo-ko-gesui Ittai Kan-min Renkei Un'ei Jigyo (Miyagi-gata Kanri Un'ei Hōshiki) Yūsen-kōshō-kensha no Sentei Kekka ni Tsuite [Miyagi Prefecture Water Works and Sewerage Integrated Public-Private Partnership Operation Project (Miyagi-type Management and Operation Method) Selection Result of Preferential Negotiating Right Holder]*, MIYAGI PREFECTURE GOV'T (Mar. 15, 2021), <https://www.pref.miyagi.jp/site/miyagigata/sentei2.html> [<https://perma.cc/6225-LYJZ>] (Japan).

<sup>360</sup> PRINCIPLES, *supra* note 45, at I-1.

<sup>361</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, KONZATSU KŪKŌ O SHIYŌ SHITE UNKŌ O OKONAU KOTO NO KYOKA [APPROVAL TO USE THE CONGESTED AIRPORTS] (Jan. 10, 2020), [https://www.mlit.go.jp/report/press/kouku04\\_hh\\_000210.html](https://www.mlit.go.jp/report/press/kouku04_hh_000210.html) [<https://perma.cc/Z8PF-U297>] (Japan).

<sup>362</sup> Kūkō Hō [Airport Act], Law No. 80 of 1956, art. 13.

<sup>363</sup> *See supra* Part III(B).

<sup>364</sup> *Id.*

<sup>365</sup> PRINCIPLES, *supra* note 45, at I-1(2).



## IV. TOWARD AN EVOLUTION OF FORMATS

A. *Concessions over Corporatization*

Building on the success of concessions amid the relatively slow progress, or apparent suspension, of stock sales, it is arguable that the government can resume the privatization of corporatized infrastructure assets through concessions. Itami Airport in Osaka, which is now a part of the bundled Kansai Airport, is the only current example of such a combination of the two formats. Since the concession format was unavailable during the wave of corporatization in the 2000s, the deal required writing a case-specific law for the corporatization of Itami Airport through a merger with Kansai Airport and the subsequent concession of the merged corporation in 2015.<sup>366</sup> While this case-specific law does not apply to other concessions, a framework allowing concessions on corporatized infrastructure can be extended to various infrastructure assets including airports, toll roads, seaports, and power stations by further amending the PFI Act.<sup>367</sup>

The combination of corporatization, the conversion of government agencies into government-owned corporations, and concessions, the creation, and sale of operating rights on government-owned assets, would offer the best of the two formats in one package by resolving concerns that discourage the government from selling stock in already corporatized infrastructure.<sup>368</sup> If concessions were introduced to further privatize corporatized infrastructure companies under government ownership, market discipline would be an added benefit.<sup>369</sup> Business would be carried out by private concessionaires, while government monitoring, under contractual relationships based on stock ownership, would protect the public interest.<sup>370</sup> The format would also bring proceeds to the government's coffers, while corporatized infrastructure would remain unmonetized under the suspended stock sales.<sup>371</sup>

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<sup>366</sup> *Kansai kokusaikūkō oyobi Ōsakakokusaikūkō no Ittai-teki katsu Kōritsu-tekina Un'ei ni Kansuru Hōritsu* [Act on the Integrated and Efficient Operation of Kansai International Airport and Osaka International Airport], Law No. 54 of 2011, arts. 1, 9, 10 (Japan); *see also* MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM OF JAPAN, *supra* note 35.

<sup>367</sup> *Id.*

<sup>368</sup> *Supra* Part III(D)(F).

<sup>369</sup> *Id.*

<sup>370</sup> *Supra* Part III(J).

<sup>371</sup> *Supra* Part III(B).

One can make a good argument that adding concessions to corporatized infrastructure will achieve privatization, and thereby reduce the fiscal burdens of the government while resolving concerns over the sale of stock in corporatized infrastructure.<sup>372</sup> Firstly, the combination will mitigate the conflicts between the public interest and market discipline regarding infrastructure which were behind the suspension of the stock sale of the corporatized Narita Airport.<sup>373</sup> The government's entering a contractual relationship with a concessionaire will lend a higher level of predictability to the operation of privatized infrastructure than would a stock sale.<sup>374</sup> Such a contractual arrangement will give the government flexibility in the design of regulatory architecture, something which is hard to achieve through other alternatives such as the writing of laws to apply specifically to a privatized company.<sup>375</sup> However, achieving predictability does not mean undermining shareholder value, since the concessionaire, unlike the government, is driven by the profit motive and governed by its own shareholders accordingly.<sup>376</sup>

Secondly, given the finite privatization period achieved through concessions alone, a combined format will give the government the option to experiment with, and if necessary unwind its privatization program.<sup>377</sup> Otherwise, unwinding would require it to take once-listed companies private by obtaining the consent of public shareholders, an unlikely prospect for a debt-laden government and a dispersed ownership structure.<sup>378</sup> With concessions, the government will have room to reconfigure and improve its regulatory architecture, at least at the end of the operating period, based on what it has learned during the period.<sup>379</sup> This will include the public's, as well as the investor's, response to privatized infrastructure.<sup>380</sup> Since stock sales are permanent, such reconfiguration through after-the-fact legislation would involve

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<sup>372</sup> *Id.*

<sup>373</sup> *Id.*

<sup>374</sup> *Supra* Part II(B).

<sup>375</sup> *Id.*

<sup>376</sup> *Supra* Part III(B).

<sup>377</sup> CONTRACT, *supra* note 54, at arts. 68, 70.

<sup>378</sup> *Annual Report on the Japanese Economy and Public Finance 2022 (Report by Minister of State for Economic and Fiscal Policy)*, CABINET OFF. OF JAPAN (July 2022), <https://www5.cao.go.jp/keizai3/2022/0729wp-keizai/setsumei-e2022.pdf> [<https://perma.cc/MBS4-JGT8>].

<sup>379</sup> CONTRACT, *supra* note 54, at art. 77.

<sup>380</sup> Kenji Hashimoto, *Yūsei Min'eika no Keshō Sono Meritto o Chūshinto Shite [Evaluation of the Privatization of Japan Post: Mainly on its Benefits]*, 346 RIPPŌ TO CHŌSA [LEGISLATION AND RESEARCH] 69, 87-88 (2013).

a loss of credibility from the investor community as well as from concessionaires, who might even demand compensation.<sup>381</sup> Such a prospect could lead the government to suspend stock sales altogether, delaying the overall privatization program and sacrificing the proceeds that would come with it.<sup>382</sup>

Lastly, another benefit of the format is that it fills any vacuum of governance caused by the corporatizing of infrastructure.<sup>383</sup> After corporatization, the government still owns the stakes, but it usually shifts to an indirect, hands-off approach in which operating responsibilities are delegated to the corporation's managers.<sup>384</sup> In a typical corporatization structure, the government has the authority to approve each year's management plan and the lineup of directors, rather than directing the day-to-day operation of the company.<sup>385</sup> An unlisted company under government ownership does not need to deal with general shareholder pressure as it would in the public markets. Government officials are also known for working long hours, as labor protection law applied to the private sector does not apply to them.<sup>386</sup> If the government has insufficient time to monitor, managers will have considerable latitude of discretion without a corresponding level of monitoring by the public shareholders who hold them accountable.<sup>387</sup> In this way, corporatization can give birth to a vacuum of governance.<sup>388</sup> Because of this structure and the possible time constraints of government officials, managers enjoy a certain degree of independence from government control while shielding themselves from the pressures of the public market. It would not be inconceivable, then, for managers to have an incentive to preserve their economic rent by looking to the same government officials who monitor their activities – and are the only ones who do so – with an indirect hand but without an incentive for value growth.<sup>389</sup>

Concessions will expose them to market discipline by profit-driven concessionaires, who themselves are under competitive

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<sup>381</sup> *Id.*

<sup>382</sup> *Id.*

<sup>383</sup> *Supra* Part III(F).

<sup>384</sup> *Id.*

<sup>385</sup> *See, e.g.*, Nippon Telegraph and Telephone Act, *supra* note 179.

<sup>386</sup> NAT'L PERS. AUTH. OF JAPAN, ANNUAL REPORT 2020 ch. 5 (n.d.), <https://www.jinji.go.jp/hakusho/pdf/1-3-5.pdf> [<https://perma.cc/X73E-8JM7>].

<sup>387</sup> *Supra* Part III(F).

<sup>388</sup> *Id.*

<sup>389</sup> *Id.*

pressure.<sup>390</sup> The format has the supplementary benefit of avoiding partial stock sales, where the government retains a significant stake, by fully transferring the business's financial risks and rewards and clarifying managerial responsibilities.<sup>391</sup> Where there is dispersed ownership with a strong government influence, partial privatization may also give rise to a governance vacuum in the sense that indirect control by the government coincides with minority shareholders lacking the incentive to monitor management.<sup>392</sup> A clear division of ownership and operating responsibilities will fill such a vacuum and enable a more incentive-compatible style of infrastructure management.<sup>393</sup>

Some cases of corporatized infrastructure, such as Narita Airport and Tokyo Metro, have had their stock sales suspended,<sup>394</sup> but there are others that have none planned at all. Noteworthy among the latter are toll roads and seaports.<sup>395</sup> The corporatization of major toll roads was achieved in 2005 by splitting a network of highways throughout the Japanese mainland into three regional companies, East Nippon Expressway Co. (E-Nexco), Central Nippon Expressway Co. (C-Nexco), and West Nippon Expressway Co. (W-Nexco),<sup>396</sup> and by establishing Metropolitan Express Co. to cover Tokyo's highway network.<sup>397</sup> This followed the corporatization of Narita Airport a year earlier; both took place under the reformist Koizumi administration.<sup>398</sup> Similarly, the two major seaports of Osaka and Kobe, in the western part of the country, were bundled for corporatization into the Kobe-Osaka

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<sup>390</sup> *Supra* Part III(B).

<sup>391</sup> PRINCIPLES, *supra* note 45, at III-2.

<sup>392</sup> Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 306 (1976).

<sup>393</sup> *Id.*

<sup>394</sup> NARITA INT'L AIRPORT CORP., NARITA KŪKŌ SONO YAKUWARI TO GENJŌ 2019-NENDO [NARITA AIRPORT: ITS ROLE AND STATUS, FISCAL YEAR 2019] 103 (2019), [https://www.naa.jp/jp/issue/yakuwarigenjyo/2019/pdf/3\\_all.pdf](https://www.naa.jp/jp/issue/yakuwarigenjyo/2019/pdf/3_all.pdf) [https://perma.cc/N4ST-HWKM]; *Tōkyō Chikatetsu Kabushiki-kaisha no Kābushiki no Shobun ni Tsuite* [On Stock Sales of Tokyo Metro Corp.], MINISTRY OF FIN. OF JAPAN (Mar. 28, 2022), [https://www.mof.go.jp/about\\_mof/councils/fiscal\\_system\\_council/sub-of\\_national\\_property/report/toushin20220328a.pdf](https://www.mof.go.jp/about_mof/councils/fiscal_system_council/sub-of_national_property/report/toushin20220328a.pdf) [https://perma.cc/769U-BH38].

<sup>395</sup> *See* Appendix.

<sup>396</sup> Nobuhiro Yamagoshi, *Dōro Kankei Yon-kōdan Min'eika no Kenshō* [Evaluation of the Privatization of Four Toll-Road Companies], 260 RIPPŌ TO CHŌSA [LEGISLATION AND RESEARCH] 35, 35-36 (2006) (Japan).

<sup>397</sup> *Id.*

<sup>398</sup> Yasuhiro Atsumi, "Koizumi Kōzō-Kaikaku" Naru Gainen ni Tsuite no Shokōsatsu [Thoughts on the Concept of "Koizumi Structural Reform"], PRI DISCUSSION PAPER SERIES (No. 06A-28) (Sept. 2009) (Japan).

International Port Co. in 2014, and those of Yokohama and Kawasaki, in the eastern region, into the Yokohama-Kawasaki International Port Co. in 2016.<sup>399</sup> But despite the concession format already being available, there was no explicit discussion of either stock sales or concessions at that time.<sup>400</sup> If the government aims to proceed with privatization while addressing the concerns that accompany stock sales, the concession format could be applied to further the privatization of corporatized toll roads and seaport infrastructure.

### B. *Fund Structure*

In the competitive bidding process for concessions, the requirement that candidates have operating capability serves to limit the scope of investors, leading to the de facto exclusion of institutional money managers, at least in the role of lead investor.<sup>401</sup> This stands in contrast to stock sales, where institutional investors, particularly sophisticated ones, are major shareholders that lead the valuation of the stock of privatized companies.<sup>402</sup> Such limits on the participants for concessions can result in a lack of capital and limit the size of deals. In fact, one of the reasons that the concession of Kansai Airport had only one bidder consortium, led by Vinci and its local partners, is that its minimum bidding price, at a total of about \$14 billion (1.64 trillion yen) for 44 years of operation, exceeded most candidates' risk-taking capacity.<sup>403</sup> The amount would not be a problem for capital-rich

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<sup>399</sup> 12-gatsu 26-nichi, *Hanshin-Kokusai-Kōwan Kabushikikaisha ni Taishite Kuni ga Shusshi Shimashita* [Government Invests in Kobe-Osaka Int'l Port Co. on Dec. 26], MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM (Dec. 2016), [https://www.mlit.go.jp/kowan/kowan\\_tk2\\_000012.html](https://www.mlit.go.jp/kowan/kowan_tk2_000012.html) [https://perma.cc/8NDX-BV8R]; *Yokohama-Kawasaki Kokusai Kowan Kabushikikaisha ni Taishite Kuni ga Shusshi Shimashita* [Government Invests in Yokohama-Kawasaki Int'l Port Co.], TTILIT (Mar. 2016), [https://www.mlit.go.jp/kowan/kowan\\_tk2\\_000016.html](https://www.mlit.go.jp/kowan/kowan_tk2_000016.html) [https://perma.cc/22PQ-HB2U].

<sup>400</sup> *Id.*

<sup>401</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-3.

<sup>402</sup> Kenji Hashimoto, *Kabushiki Jōjō ni Muketa Yūsei Jigyō no Kadai, Yunibāsarū Sābisu no Kakuho, Keiei Kiban no Kyōka to no Chōwa* [Issues of Japan Post for Stock Listing: Coordination of Providing Universal Services and Strengthening Managerial Base etc.], 360 RIPPŌ TO CHŌSA [LEGISLATION AND RESEARCH] 13, 24 (2015).

<sup>403</sup> See NEW KANSAI INT'L AIRPORT CO., *supra* note 128; see also, *The Privatization of Airports by Concession*, SUMITOMO MITSUI TR. RSCH. INST. (Aug. 19, 2016), [https://www.smtri.jp/report\\_column/infra\\_ivst/pdf/InfraUPDATES\\_Concession.pdf](https://www.smtri.jp/report_column/infra_ivst/pdf/InfraUPDATES_Concession.pdf) [https://perma.cc/PY6B-QSFF] (Japan).

institutional money managers, who look for infrastructure investment opportunities in advanced economies with legal stability.<sup>404</sup>

A solution to this problem is to promote a fund structure, with concessionaires forming an investment vehicle such as a limited partnership based on the Limited Partnership Act for Investment of 1998, which itself is modeled on U.S. limited partnerships and is regularly used for institutional investors in private equity and venture capital funds in Japan.<sup>405</sup> So far, direct investments by corporations with operating capabilities have been preferred in competitive bids for concessions, even where the use of limited partnership is allowed.<sup>406</sup> Under a limited partnership structure, a consortium of sponsors forms a general partner entity, after which it forms a limited partnership to raise funds from limited partners.<sup>407</sup> Along with the consortium's own investment, these funds are used to finance the purchase of the operating right, which may be bridged by bank loans.<sup>408</sup> In this structure, the general partner has full responsibility for operating the infrastructure, in line with the government's requirement that concessionaires have operating capabilities for infrastructure assets.<sup>409</sup>

Institutional investors are given protection as limited partners, unlike investors in non-voting shares.<sup>410</sup> Limited partners also enjoy liquidity, as the government makes clear that its approval is unnecessary for the transfer of their interests when approved by general partners.<sup>411</sup> A fund governance structure typically gives limited partners the right to access disclosure, vote on changes in the terms and conditions of

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<sup>404</sup> GLOB. INFRASTRUCTURE HUB, *supra* note 1.

<sup>405</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-2(9); Tōshi Jigyō Yūgen Sekinin Kumiai Keiyaku ni Kansuru Hōritsu [Limited Partnership Act for Investment], Law No. 90 of 1998.

<sup>406</sup> See CABINET OFF. OF JAPAN, KŌKYŌ SHISETSU-TŌ UN'EI-KEN OYOBI KŌKYŌ SHISETSU-TŌ UN'EI JIGYŌ NI KANSURU GAIDORAIN [GUIDELINES FOR PUBLIC FACILITIES OPERATING RIGHT AND PUBLIC FACILITIES OPERATING BUSINESS] 13-2-4 (2021), [https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken\\_guideline.pdf](https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken_guideline.pdf) [<https://perma.cc/9X29-AQ6G>] (Japan); see also Masanori Sato, *Issues and Prospects for Concessions/PPP*, 13 MORI HAMADA & MATSUMOTO ENERGY & INFRASTRUCTURE BULL. 1 (2018) (Japan).

<sup>407</sup> CABINET OFF. OF JAPAN, KŌKYŌ SHISETSU-TŌ UN'EI-KEN OYOBI KŌKYŌ SHISETSU-TŌ UN'EI JIGYŌ NI KANSURU GAIDORAIN [GUIDELINES FOR PUBLIC FACILITIES OPERATING RIGHT AND PUBLIC FACILITIES OPERATING BUSINESS] 13-2-4 (2021), [https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken\\_guideline.pdf](https://www8.cao.go.jp/pfi/hourei/guideline/pdf/uneiken_guideline.pdf) [<https://perma.cc/9X29-AQ6G>] (Japan).

<sup>408</sup> *Id.*

<sup>409</sup> IMPLEMENTATION POLICY, *supra* note 46, at III-3.

<sup>410</sup> *Id.* at IV-4(2).

<sup>411</sup> CABINET OFF. OF JAPAN, *supra* note 406.

fund investments, and replace general partners by collective vote.<sup>412</sup> While the replacement right may be at odds with the government's emphasis on operating capabilities, past practice shows that banks providing financing for the purchase of an operating right secure a mortgage on it.<sup>413</sup> This entitles them to sell the right if a borrower concessionaire defaults on debt, potentially leading to a change in concessionaires.<sup>414</sup>

In this way, operating capabilities remain with the general partner entity which has responsibility for operations, while institutional investors, which lack operating capabilities, participate with protection in the fund structure but without a requirement that they have operating capabilities. Compared to direct investments by sponsors, the structure allows a substantial part of an investment to be liquidated through limited partner investments, thus enabling a private equity investment in long-term assets. Liquidity may be created even at the general partner level if an operation is outsourced by a limited partnership through contracts with operating companies, in which case the general partner's responsibility extends only to the selection and monitoring of those operating companies.<sup>415</sup>

So far, there has been no case of the limited partnership structure being used by the sponsors of a concession. Part of the reason for its absence is its unfamiliarity to both the government and sponsors in relation to concessions. This stands in contrast to commercial real estate investments, where the structure is already prevalent, and to renewable energy investments, which use an investment trust structure based on the Investment Trust Act as well as limited partnerships.<sup>416</sup>

Wider adoption of the fund structure will improve the investment capacity of sponsors, who would be reluctant to sell their voting shares for liquidity even with government approval, as the move might damage their reputation as long-term operators and have a negative impact on future opportunities in competitive bids for concessions. The use of a limited partnership provides such concessionaires with avenues

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<sup>412</sup> Sato, *supra* note 406.

<sup>413</sup> CONTRACT, *supra* note 54, at art. 58.

<sup>414</sup> *Id.*

<sup>415</sup> TRADE & INDUS. MINISTRY OF ECON., TŌSHI JIGYŌ YŪGEN SEKININ KUMIAI MODERU KEIYAKU [LIMITED PARTNERSHIP MODEL CONTRACT] art. 14 (Nov. 2010), [https://www.meti.go.jp/policy/economy/keiei\\_innovation/sangyokinyu/lps\\_model2211.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/sangyokinyu/lps_model2211.pdf) [<https://perma.cc/BC5E-3NK4>] (Japan).

<sup>416</sup> NISHIMURA ASAHI HŌRITU JIMUSHO [NISHIMURA & ASAHI], 2 FAINANSU HŌ TAIZEN (JŌ) ZENTEI-BAN [CORPUS JURIS FINANCE (VOL. I), REVISED ED.] 346, n.319 (2017).

for liquidating a substantial part of their investments while maintaining operating responsibility in the long run. It also enables participation by institutional investors and expands the pool of available private capital, which the government hopes to utilize through its privatization agendas.

### C. *Extension to BTO*

Concessions have principally been used in operating existing infrastructure assets, but they can also be effective in building new ones.<sup>417</sup> This is facilitated by using the fund structure, which enables raising a large amount of capital from institutional investors.<sup>418</sup> At present, the construction of new infrastructure assets with private capital for later operation by the private sector is largely conducted under the build-transfer-operate (“BTO”) model, which is part of the private finance initiative (“PFI”) format for outsourcing the building and operation of public facilities at the cost and risk of the government.<sup>419</sup> Under the BTO model, the private sector builds infrastructure, transfers the assets to the government, and operates them on behalf of the government during a contracted period. Unlike a concession, the private operator assumes no financial risk for the underlying assets.<sup>420</sup>

Currently, concessions are structured mainly for competitive bids for the operation of existing assets, rather than the building of new ones. A rare exception is the concession of faculty residences for a public university, where construction costs are offset by payments for the operating rights, and the concessionaire recovers its investment through future rent payments as with a commercial real estate investment.<sup>421</sup> Under current practice, the government typically builds an

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<sup>417</sup> Teruyuki Yamamoto, *Kōkyo Shisetsu Shinsetsu no Atarashii PFI Jigyō Ruikei “BT-Konsesshon”* [A New PFI Format to Build New Public Facilities: BT Concession], RONZA (Dec. 8, 2021), <https://webronza.asahi.com/judiciary/articles/2021120600003.html?page=1> [<https://perma.cc/G6R6-T3M7>] (Japan).

<sup>418</sup> *Supra* Part IV(B).

<sup>419</sup> CABINET OFF. OF JAPAN, KEIYAKU NI KANSURU GAIDORAIN - PFI JIGYŌ KEIYAKU NI OKERU RYŪI-JIKŌ NI TSUITE - [CONTRACT GUIDELINES - POINTS TO CONSIDER IN PFI BUSINESS CONTRACTS - ] 2-4-1 (2021), [https://www8.cao.go.jp/pfi/hourei/guideline/pdf/keiyaku\\_guideline.pdf](https://www8.cao.go.jp/pfi/hourei/guideline/pdf/keiyaku_guideline.pdf) [<https://perma.cc/FJ6V-8FMH>] (Japan).

<sup>420</sup> Yamamoto, *supra* note 417.

<sup>421</sup> OKINAWA INST. SCI. & TECH. GRADUATE UNIV., OKINAWA KAGAKU GIJUTSU DAIGAKUIN KIBO KAKUCHŌ NI TOMONAU SHUKUSHA SEIBI UN’EI JIGYŌ BOSHŪ YŌKŌ [APPLICATION GUIDELINES FOR RESIDENTIAL BUILDING CONCESSIONS] (Aug. 2018), <https://oist-prod-www.s3-ap-northeast-1.amazonaws.com/s3fs->



infrastructure asset either by itself or by outsourcing it and subsequently creates an operating right on it for concession.<sup>422</sup> This practice doubles the required processes, time, and costs. Further, the possibility of the two phases being undertaken by separate consortiums reduces the incentive of a potential concessionaire to participate, as its design and operation ideas can be appropriated by a competitor if it wins in the building phase but loses in the operation phase.<sup>423</sup> Similarly, a concessionaire who loses in the former phase but wins in the latter will find the asset awkward to operate, as designs will be incompatible with its own ideas and styles.<sup>424</sup> That existing infrastructure is not optimally configured for operation is apparent in the fact that concessionaires, without exception, invest significantly at the outset to make the assets they operate more attractive to users and commercially viable.<sup>425</sup>

Instead, the concession format should be expanded to include the building of new infrastructure assets rather than limited to the operation of existing ones. This will enable concessionaires to design, build, and operate the infrastructure at their own cost and risk throughout the operating period. When combined with the fund structure, risk will be shared by institutional investors, as is regularly done for commercial real estate investments.<sup>426</sup> To achieve this will require amending the PFI Act, which currently defines concessions as the operations of existing assets, and requires a case-specific interpretation to include the building of new assets.<sup>427</sup> This stands in contrast to concessions in countries of origin, such as France and the United States, which have built canals and toll roads using concessions.<sup>428</sup> The amendment should permit concessionaires to design and build infrastructure before operating it for recovery of their initial investments. This will not only incentivize potential candidates to design, build, and operate

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public/procurement/1.%20Guidelines%20for%20Applicants.pdf  
[<https://perma.cc/6UES-RN3K>].

<sup>422</sup> PFI Act, *supra* note 7, at art. 2(6).

<sup>423</sup> Yamamoto, *supra* note 417.

<sup>424</sup> *Id.*

<sup>425</sup> *Id.*

<sup>426</sup> Press Release, Ministry of Land, Infrastructure, Transp. & Tourism, Reiwa 3-nendo no Shōkenka Taisho Fudōsan no Shisan Sōgaku wa Yaku 46.8-cho en [Real Estate Assets for Securitization amounts to 46.8 trillion yen in Fiscal Year 2021] (Aug. 1, 2022), <https://www.mlit.go.jp/report/press/content/001493195.pdf> [<https://perma.cc/MQJ9-2JQH>] (Japan).

<sup>427</sup> CABINET OFF. OF JAPAN, *supra* note 419, at 1(16); *see also* CONTRACT, *supra* note 54, at art. 40.

<sup>428</sup> EDWARD R. YESCOMBE & EDWARD FARQUHARSON, PUBLIC-PRIVATE PARTNERSHIPS IN INFRASTRUCTURE 12, 38 (2d ed. 2018).

infrastructure in a consistent manner but reduce the government's burdens in financing infrastructure construction. And, to the extent that this consistency lessens additional investments at the outset of the operation, it will save the taxpayer money.

Accentuating the need for this change is the fact that the government already announces concessions for infrastructure before the completion of construction.<sup>429</sup> A case in point is the stadium used as the main arena for the Tokyo Olympics, held in 2021 after a one-year postponement due to the pandemic.<sup>430</sup> Even before the stadium's completion at a cost of \$1.3 billion (156.9 billion yen), the government made its intentions public, and schedule for a concession contract after the conclusion of the games to recover, even if not fully, its investment in the stadium.<sup>431</sup> However, if the government had arranged for both the construction and operation of the stadium to be carried out by a concessionaire, this would have incentivized candidates to design, build, and operate better and more commercially feasible infrastructure from a long-term perspective.

The reason that infrastructure construction has continued to be the purview of the government rather than the private sector may reflect a combination of factors: assets such as roads and seaports tend to be unprofitable; they require a political process for their budgeting and construction; and the government, both central and municipal, has a group of its own officials and engineers involved in the undertaking of such public works.<sup>432</sup> The change would thus have a far from negligible impact in a country with a traditionally illiquid labor market,<sup>433</sup> possibly leading to a greater transfer of employment from the public sector to the private. However, as the operation moves increasingly to the private sector through concessions and the government builds infrastructure with privatization in mind, it will be a logical extension

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<sup>429</sup> *KOKURITSU KYŌGIJŌ TOKUTEI UN'EI JIGYŌ-TŌ NO JISSHI NI KAKARU PURE-HIARINGU* [PRE-HEARING ON THE CONCESSION OF JAPAN NATIONAL STADIUM], JAPAN SPORT COUNCIL (Nov. 5, 2021), <https://www.jpnsport.go.jp/kokuritu/tabid/452/Default.aspx> [<https://perma.cc/QG6G-YYR2>].

<sup>430</sup> *Id.*

<sup>431</sup> *Id.*

<sup>432</sup> REIWA 4-NENDO YOSAN KETTEI GAIYŌ [THE SUMMARY OF THE BUDGET OF FISCAL YEAR 2022], MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM (Dec. 2021), <https://www.mlit.go.jp/page/content/001447029.pdf> [<https://perma.cc/NW5C-KZ86>] (Japan).

<sup>433</sup> CABINET OFF. OF JAPAN, HEISEI 30-NENDO NENJI KEIZAI ZAISEI HOKOKU [ANNUAL REPORT ON THE JAPANESE ECONOMY AND PUBLIC FINANCE FISCAL YEAR 2018] ch. 2 (Aug. 2018).

for the government to deploy concessions from the outset through the construction and operation phases.

## V. CONCLUSION

The Article argued that the Japanese government, having introduced concessions in 2011, has expanded privatization through the format over the past decade while limiting it through stock sales which had been the mainstream format until then. Given the policy advantages of concessions over stock sales, the government's apparent policy is a reasonable one: concessions bring the greater proceeds it needs to mitigate its fiscal burdens in the current environment and offer contractual flexibility over the degree of government involvement, the option to unwind privatization after a finite period, and less conflict between public interest and shareholder activism involving infrastructure assets.<sup>434</sup> This last factor was presumably a trigger for introducing the format, although, with the introduction of the stewardship code in 2014 and the corporate governance code in 2015,<sup>435</sup> the public seems more accommodating to shareholder activism than in the 2000s.

However, concessions are not without costs and the format is often accompanied by underinvestment toward the end of the finite operating period. The problem becomes more severe with investments in intangible assets, as their valuation is more uncertain than tangible ones, which can be booked and resold at the end of the period. With infrastructure featuring more and more intangible aspects, as seen in the myriad of "smart" technologies,<sup>436</sup> the risk of being unable to recover one's investments in those intangibles could hinder the development of quality infrastructure merely because of the choice of format.

At the same time, the use of concessions requires the government to be bound by contracts, giving it less discretion over supervision.<sup>437</sup> This is a relatively new avenue for governing infrastructure assets and administering public services in general. It reflects a shift in a mature society that puts faith in contracts and their enforcement through institutional proceedings under the rule of law. The Japanese government will tread a thin line between protecting the public interest and thereby maintaining well-functioning infrastructure and protecting the

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<sup>434</sup> *Supra* Part II(B)(C)(D), Part III(B).

<sup>435</sup> THE COUNCIL OF EXPERTS ON THE STEWARDSHIP CODE, *supra* note 284; TOKYO STOCK EXCH., *supra* note 169.

<sup>436</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, *supra* note 234.

<sup>437</sup> *Supra* Part III(F).

investor's interest and thereby mitigating its own fiscal burden for the assets' maintenance. With higher expenditures on welfare policies looming for the rapidly aging country,<sup>438</sup> the day is not too far ahead when the government, after its wide-ranging spending during the pandemic, will face greater fiscal constraints and rely even more on private capital for infrastructure investments.<sup>439</sup>

Concessions can be encouraged by drawing upon the format's advantages. It would be worthwhile to consider expanding the measures taken for the \$15 billion (2 trillion yen) privatization of Kansai Airport to offer concessions on corporatized infrastructure assets.<sup>440</sup> Combining the formats will promote the privatization of existing corporatized infrastructure which presumably had been meant to undergo a stock sale at the time of conversion but remained under government ownership after the wave of shareholder activism. To support large-scale privatization programs drawing on capital from institutional investors, it is necessary to promote the use of limited partnerships as a vehicle for investing in the operating rights of infrastructure, with the responsibility for operations concentrated on a general partner formed by sponsors.<sup>441</sup> With this vehicle, institutional investors that take part in privatization would not need to have operating capability for underlying assets but would have protection as limited partners under a fund-governance structure. And, with greater participation by institutional investors, the concession format could, and should, be extended to include the construction of new infrastructure assets as opposed to merely operating existing ones, thus further reducing the government's need to finance infrastructure and improving consistency across the design, construction, and operation phases.<sup>442</sup> These are changes that will accelerate infrastructure investments using private capital. For a debt-laden Japanese government in need of infrastructure investments, this will be an important item on the agenda.

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<sup>438</sup> MINISTRY OF LAND, INFRASTRUCTURE, TRANSP. & TOURISM, *supra* note 216.

<sup>439</sup> *Id.*

<sup>440</sup> *Supra* Part IV(A).

<sup>441</sup> *Supra* Part IV(B).

<sup>442</sup> *Supra* Part IV(C).

## APPENDIX

*Infrastructure privatization with stock sales, concessions, and corporatization, 2000-2020*

“Year” shows the time when stock sales or concession contracts were concluded for transfer to the private sector, or when a corporation was established for the corporatization of a government agency.

Format	Sector	Entity	Year
Stock sales	Energy	J-Power Co. (Wholesale power producer)	2004
	Railway	Japan Railway (JR) Kyushu Co.	2016
	Postal service	Japan Post Holdings Co. (Parent of Japan Post, Bank, and Insurance)	2015
	Banking	Japan Post Bank Co.	2015
	Insurance	Japan Post Insurance Co.	2015
Concessions	Energy	Water Power, Tottori Pref.	2020
		Otsu City Gas, Shiga Pref.	2018
	Airport	Tajima Airport, Hyogo Pref.	2015
		Kansai International Airport, Osaka Pref.	2015
		Sendai Airport, Miyagi Pref.	2015
		Takamatsu Airport, Kochi Pref.	2017
		Kobe Airport, Hyogo Pref.	2017
		Tottori Airport, Tottori Pref.	2018
		Fukuoka Airport, Fukuoka Pref.	2018
		Shizuoka Airport, Shizuoka Pref.	2018
		Nanki-Shirahama Airport, Wakayama Pref.	2018
		Kumamoto Airport, Kumamoto Pref.	2019
		Seven Hokkaido Airports, Hokkaido.	2019
		Hiroshima Airport, Hiroshima Pref.	2020
		Road	Aichi Toll Road, Aichi Pref.
	Water and sewage	Hamamatsu City Sewage, Shizuoka Pref.	2017
		Suzaki City Sewage, Kochi Pref.	2019
Miyagi Pref. Water and Sewage		2021	

	Convention center	Yokohama-Minatomirai International Convention Center, Kanagawa Pref.	2017
		Aichi International Convention and Exhibition Center, Aichi Pref.	2019
	Educational facility	Former Nara Prison, Nara Pref.	2017
	Faculty residence	Okinawa Institute of Science and Technology Graduate University, Okinawa Pref.	2020
	Station building	Tagawa Station, Fukuoka Pref.	2018
	Art facility	Artists & Entrepreneurs Center, Fukuoka Pref.	2017
	Sports arena	Ariake Arena, Tokyo	2019
	Art museum	Nakanoshima Museum, Osaka	2020
Corporatization	Airport	Narita Airport Co.	2004
	Seaport	Yokohama-Kawasaki International Port Co.	2016
		Kobe-Osaka International Port Co.	2014
	Subway	Tokyo Metro Co.	2004
		Osaka Metro Co.	2017
	Road	East Nippon Expressway Co.	2005
		West Nippon Expressway Co.	2005
		Central Nippon Expressway Co.	2005
		Metropolitan Expressway Co.	2005
	Banking	Japan Finance Corporation Co.	2008
		Development Bank of Japan Co.	2008
Japan Bank for International Cooperation Co.		2008	