The Construction Contract in Japan from a German Perspective

Andreas Kaiser[*]

---

* Dr. Andreas Kaiser, Registered Foreign Attorney (German Law), Of Counsel, Atsumi & Sakai (Tokyo).

This article analyzes the General Conditions of Construction Contract[1] usually used for the construction of buildings or industrial installations in Japan in comparison with the BGB (German Civil Code)[2] and VOB/B (Part B of the Construction Contract Procedures).[3] The analysis aims to provide owners and contractors who are involved in construction projects in Japan with a basic understanding of the Japanese standard terms and conditions from a German legal point of view.

I. CONCEPTION OF THE CONSTRUCTION CONTRACT

A relatively short construction contract fixes the *essentialia negotii* between the owner (*hatchū-sha*) and the contractor (*jūchū-sha*),[4] such as title of the work, site, contract time, contract sum, payment terms, partial use, partial delivery and dispute resolution, method of guaranteeing fulfillment of defect liabilities by the contractor, expenses required for demolition work, and other matters. The construction contract is also the place for the parties to record freely negotiated contract terms and conditions with priority over general terms and conditions.

The short construction contract is supplemented by the General Conditions of Construction Contract approved by a committee consisting of various nationwide associations of architects, building engineers, and general contractors (hereinafter General Conditions or GC). Further integral parts of the contract are the design drawings and specifications, on-site orientation records, and written answers to queries ("design documents"). Those documents form "the contract". Further documents are usually added as exhibits, which shall not be discussed herein. During the construction period the contract may be amended from time to time, and such amendments then become integral parts of the contract.

The concept of this type of contract is that of a general contractor contract. The general contractor performs building work of all kinds for a built property, although it depends on the individual case as to whether he also undertakes partial or all planning

---

1 Published by the General Conditions of Construction Contract Committee (GCCCC). An English translation is available, prepared by the Management Research Society for Construction Industry (the translation is not officially approved by GCCC). Available at: *http://www.gccc.jp/cgi-bin/opinion.html*, last accessed on 29 July 2013. I refer to the version revised in May 2011.

2 Bürgerliches Gesetzbuch (BGB) in the version promulgated on 2 January 2002, Bundesgesetzblatt (Federal Law Gazette) I p. 42; 18 July 2002, I p. 2909; 22 May 2003, I p. 738), last amended by Art. 1 of the statute of 27 July 2011, Federal Law Gazette I p. 1600.

3 Vergabe- und Vertragsordnung für Bauleistungen, Teil B (VOB/B), the general conditions of contract relating to the execution of construction work, promulgated on 31 July 2009, Bundesanzeiger (Federal Gazette) No. 155 of 15 October 2009, last amended on 26 June 2012, Federal Gazette AT, 13 July 2012, B3.

4 "Owner" does not necessarily mean that he owns something. Different terminology to designate the parties is used by the Civil Code, BGB, and VOB/B.

services. The general contractor usually has significant parts of the services that are transferred to him carried out by sub-contractors. An administrative architect, who concludes a separate agreement with the owner and cooperates in facilitating the performance of the contract, administers the contract. The owner may entrust other services to the administrative architect.

The contractor shall complete the work and deliver the permanent work to the owner, and the owner shall then complete the payment of the contract sum to the contractor. The work may consist of the construction or conversion of a building, or a part of a building, or an industrial installation.

II. Statutory Sources of Japanese Law

The main sources of Japanese law applying to the contract or referred to therein can be found in the Civil Code (Act No. 89/1896, hereinafter CC), Building Standards Act (Act No. 201/1950), Construction Business Act (Act No. 100/1949), Licensed Architects Act (Act No. 202/1950), Housing Quality Assurance Act (Act No. 81/1999), Act for Execution of Defects Warranty Liability (Act No. 66/2007), the Construction Materials Recycling Act (Act No. 104/2000), and various Cabinet Orders and Ministerial Ordinances.

III. Formal Requirements for the Construction Contract

In witness of the parties' agreement, the contract is usually in writing and prepared in duplicate and the respective parties and the sureties, if any, put thereunto their seals and names. The involvement of a notary is not required. The contract requires the affixing of a revenue stamp, which seems not to be a requirement for its validity, however. As a general principle, consultations, acceptances, approvals, confirmations, notifications, instructions, or requests based on articles of General Conditions shall be made in written form unless otherwise specified in General Conditions (Art. 1 (6) GC). The contract is in Japanese with an English translation and provides that in case of any differences in interpretation between the Japanese and English texts, the Japanese text shall prevail.

IV. The Construction of the Agreed Work

1. The Construction Work Owed

The construction of the agreed work is primarily determined by the design documents. These are supplemented by technical standards for buildings, even without this being expressively agreed. The Building Standards Act prescribes "building codes" and "zoning codes." The building codes are technical standards for all buildings in order to ensure building safety with regards to structural strength, fire prevention devices, equip-

ment, and sanitation. The zoning codes are technical standards to ensure rational and safe utilization of land and to improve environment.

A contract for the purpose of the construction of a building that does not meet the rules of laws and ordinances such as the Building Standards Act may, according to the circumstances of the case, be regarded as against public order and morals (Art. 90 CC) and as invalid.[5]

2. Unilateral Order of Change in Performance

a) German Law

Pursuant to § 1 no. 3 VOB/B, the owner is entitled to reserve the right to order changes in the construction plan (*Änderungen des Bauentwurfs*). In addition, § 1 no. 4 VOB/B provides that the contractor must, at the owner's request, also execute any work that has not been agreed upon but becomes necessary for the execution of the contractual performance (*Notwendige Zusatzleistungen*). The financial interests of the contractor are safeguarded in these cases by the possibility of adjusting the remuneration (§ 2 no. 5, no. 6, no. 7 VOB/B).

b) Japanese Law

Under Art. 28 (1) and (2) GC, the owner may, when necessary, order additional or extra work or changes in the work. The contractor may then propose to the owner changes in the work (including but not limited to the construction methods) and the amount of increase or decrease in the contract sum likely to be caused by such changes. In such a case, the owner may make changes in the work upon his written consent to said proposal (Art. 28 (3) GC). The contractor may make a claim for the damages against the owner if any loss or damage has been caused to the contractor by the change of the contract time (Art. 28 (4) GC (comp. XII. 2. below)).

Furthermore, under Art. 29 (1) lit. a) GC, the owner or the contractor may claim adjustment of the contract sum, *inter alia,* in the event that additional or extra work or changes in the work are ordered.

V. REMUNERATION OF CONSTRUCTION WORK

1. Contract Sum

While various types of prices can be agreed, the contract is typically a lump-sum contract. In the contract a specific amount of money is laid down in advance for the entire work to be performed (construction sum) and consumption tax and local consumption tax are added (contract sum). Fixing a lump-sum amount means that the amount of the agreed remuneration is in principle independent of the amount of actual work per-

5 Supreme Court, 16 December 2011, in: Shūmin 238, 297.

formed. Thus, both parties bear the risk that the work actually to be performed differs from the assumption at the time of concluding the agreement. The contractor may have to perform extra quantities for the same price, and the owner has to pay the same price even if the quantities are much smaller than assumed.

2. Price Alterations

a) German Law

In principle, the lump-sum price cannot be changed (§ 2 no. 7 (1) sentence 1 VOB/B). However, if the performance executed varies from the contractually foreseen performance so substantially that it is no longer reasonable to adhere to the lump sum (§ 313 BGB), re-compensation must be granted upon request with due regard to the additional or reduced costs (§ 2 no. 7 (1) sentence 2 VOB/B).

b) Japanese Law

Art. 29 (1) GC stipulates a catalogue of events where the owner or contractor may make a claim to adjustment of the contract sum,

(a) where additional or extra work is ordered (see IV. 2 .b) above);
(b) if the contract time is changed;
(c) if additional or extra cost is incurred due to the coordination of closely related work (Art. 3 GC);
(d) if there are changes in the items, quantities, times for delivery, places of delivery, or places for return of the furnished materials or the lent articles;
(e) if, during the term of the contract, the contract sum has become apparently inappropriate and improper due to an enactment, revision, or abrogation of any law, ordinance, or regulation, drastic change in economic conditions, or any other unforeseeable cause;
(f) if, in a long-term contract, the amount of the contract sum corresponding to any portion of the work that shall have been executed thereunder after the first anniversary of conclusion of the contract is inappropriate and improper due to an enactment, revision, or abrogation of any law, ordinance, or regulation or due to any change in commodity prices, wages, and other such matters; or
(g) if the amount of the contract sum for the work, which has been suspended or affected by disaster, becomes apparently inappropriate and improper when such work is resumed.

VI. The Time at Which Remuneration Falls Due

1. German Law

The BGB provides that remuneration shall be paid upon acceptance of the work (§ 641 (1) BGB); the issuance of an invoice is not a precondition thereof. Pursuant to § 632a BGB, the contractor can also demand part payments in the amount in which the owner has received an increased value by virtue of the work, if these parts pass into the own-

er's ownership, or if ownership does not pass, then if security is provided for the part payment.

In addition, § 641 (2) BGB provides that the contractor's remuneration falls due if and to the extent to which the owner has in turn promised the production of the work to a third party and has received his remuneration, or part of it, from the third party in return for the promised work.

In accordance with § 16 no. 1 VOB/B, part payments are to be granted upon request of the contractor in the shortest possible temporal intervals or as of the stipulated dates in the amount of the performances documented as pursuant to the contract. Part payments become due within 18 working days after receipt of the itemized list.

The claim to final payment falls due immediately after the examination and approval of the final invoice presented by the contractor, though at the latest within two months after receipt (§ 16 no. 3 VOB/B).

The contractor has a claim to advance payments only on the basis of a special agreement to this effect. Advance payments give the contractor a financial advantage and may be used to make the contract price more attractive for the owner. Advance payment prevents the contractor from performing "advance services" as defined in § 648a BGB (builder's security) and demanding security for them.

2. Japanese Law

Under Art. 633 CC the remuneration shall be paid simultaneously with the delivery of the subject matter of the work.

Art. 26 (1) GC stipulates that the owner shall make the full and final payment of the contract sum to the contractor at the time when the contractor delivers the permanent work, after the work has passed final inspection, unless otherwise provided in the construction contract.

The contractor may apply for part payment of the contract sum prior to completion of the work only if provided for in the construction contract (Art. 26 (1) sentence 1 GC). In such a case, the construction contract shall clearly state the due dates or the preconditions of payment due. The construction contract may stipulate that part payment is to be made on a progress basis, for the executed portion of the work, the materials, and the building equipment that have passed inspection by the administrative architect (Art. 26 (2) GC). The invoice, called "application for payment" in the English translation (*seikyū-sho* in Japanese), first needs to be reviewed by the administrative architect and then sent to the owner by such date as is required under the construction contract (Art. 26 (3) GC). Advance payments can be claimed on the basis of a special agreement to this effect.

VII. The Limitation of the Claim to Remuneration

1. German Law

The limitation period for the claim to remuneration by the contractor out of the construction contract is three years (§ 195 BGB). The limitation period begins to run at the end of the year in which the claim arose and the contractor obtained knowledge thereof (§ 199 BGB).

2. Japanese Law

Claims of contractors in respect of the execution of construction works lapse if not exercised for three years (Art. 170 no. 2 CC). Extinctive prescription begins to run from the time when the right is capable of being exercised (Art. 166 (1) CC). This is the case at the time when the contractor delivers the permanent work to the owner (Art. 26 (1) GC).

VIII. Allocation of Risk

The concept of risk means the risk faced by one contractual party that he would have to bear the economic consequences of accidental destruction or deterioration of the work performed or accidental destruction or deterioration of the materials supplied by one party during the period of fulfillment of the contract.

Therefore, risk concerns the consequences of the effects of accidental events on the building work, such as fire, theft, natural catastrophes, etc. The risk resulting for the parties from the regulations on the allocation of risks is usually covered by insurance.

1. German Law

Under the expressive provision of § 644 (1) BGB, the contractor bears the risk until acceptance of the work (*Gefahrtragung*). If the owner is in default of acceptance, then the risk passes to him. The contractor is not liable for any accidental destruction or deterioration of the materials supplied by the owner.

If VOB/B has been agreed, then the risk already passes from the contractor to the owner before the acceptance if the work executed in whole or in part is damaged or destroyed before acceptance by force majeure, war, unrest, or other objectively unavoidable circumstances for which the contractor is not responsible (§ 7 no. 1 VOB/B). This shift of risk from contractor to owner may seem unfair from the dogmatic standpoint that the contractor owes a success; on the other hand, the contractor has often already invested substantial amounts of material and work to fulfill his obligation. The owner shall compensate such loss or damages and the contractor remains obliged to complete the work.

2. Japanese Law

There is no specific provision in the Civil Code with regards to passing of risk in contracts for work. In principle, it seems the contractor bears the risk of loss or damage that

may occur before delivery if no party is to blame for it. In the worst case, where the completed work burns down due to no one's fault before delivery, the obligor would have to pay for the loss or damage and deliver the contracted work. It is not clear whether there may be recourse to the general rule of Art. 534 CC. Where the creation or transfer of a real right over a specific or specified thing is the object of a bilateral contract, the rule provides that an obligee bears the risk of loss or damages if the specified thing is lost or damaged by any cause for which the other party is not responsible.

In a case where the performance of the obligation becomes impossible due to a cause for which neither party is responsible, the obligor loses its right to counter performance (Art. 536 (1) CC); in other words, the contractor may not claim the contract sum. Though it is not stipulated in the Civil Code, it is commonly agreed that the obligor (contractor) is released from his performance obligation in case of impossibility not attributable to him. Impossibility of performance (*rikō funō*) exists where performance is physically impossible, or is actually so onerous that performance is unreasonable, or if performance is unreasonable for legal or social reasons.[6]

The General Conditions put the burden of risk in principle on the contractor, who shall be liable for any loss or damage which has been caused to the permanent work, materials, building equipment, the furnished materials or the lent articles, arising out of or relating to execution of the work prior to the completion and delivery of the work (Art. 20 (1) GC).

The owner is only liable for loss or damage arising from certain enumerated events (Art. 20 (2) GC), namely where

(a) the contractor was unable to commence the work due to a cause attributable to the owner, or the owner has postponed the commencement of the work;
(b) the contractor has delayed or suspended execution of the work due to the delay in the delivery of the furnished materials or the lent articles (supplied by the owner);
(c) the contractor has not commenced or has suspended execution of work due to a delay of advance or partial payments; or
(d) if such loss or damage is due to any other cause attributable to the owner or the administrative architect.

Art. 21 GC provides that the owner shall, in principle, be liable for any loss or damage due to a natural catastrophe (*tensai*) or other natural or artificial cause for which neither party is responsible ("force majeure" or *fu-kakō-ryoku* in Japanese), upon consultations among the owner, administrative architect, and contractor, if such loss or damage is found as serious, and if it is found that the contractor has exercised due care and attention to prevent such loss or damage.

---

6 K. YAMAMOTO, § 10: Vertragsrecht (Contract Law), in: Baum / Bälz (eds.), Handbuch japanisches Handels- und Wirtschaftsrecht, 494.

The contractor has the obligation to immediately notify the owner of the details of any loss or damage, if any executed portion of the work, temporary work, materials, and/or building equipment, including the furnished materials paid for by the contractor, delivered to the site, or construction equipment, suffers any loss or damage due to force majeure. If such loss or damage is covered by fire insurance, contractor's all-risk insurance (*kensetsu kōji hoken*), or otherwise, any amount recovered shall be deducted from the amount to be borne by the owner.

The contractor, during execution of the work, has the obligation to purchase and maintain fire insurance or contractor's all-risk insurance (Art. 22 GC).

IX. Acceptance

1. Concept of Acceptance

a) German Law

The owner is obliged to accept the work produced in conformity with the contract (§ 640 BGB, § 12 no. 1 VOB/B). "Acceptance" means the physical taking together with the acknowledgement that the work substantially conforms to the agreed performance.[7] Acceptance may not be refused by reason of trivial defects (§ 640 (1) sentence 2 BGB, § 12 no. 3 VOB/B). Fictitious acceptance is deemed if the owner fails to accept the contractor's services within a time limit set by the contractor, although he is under a duty to do so (§ 640 (1) sentence 3 BGB). Under certain preconditions, acceptance can be replaced by an expert's certificate of completion (§ 641a BGB).

b) Japanese Law

The comparable concept of acceptance under the General Conditions is as follows. When receiving a notice of completion from the contractor, the administrative architect shall promptly carry out the inspection (Art. 23 (1) GC) and the results of this inspection are set down in the records. When the work has passed inspection, the administrative architect confirms the completion of the work (Art. 9 (1) lit. k) GC) and the contractor shall deliver the permanent work, and at the same time the owner shall make the payment of the contract sum (Art. 26 (1) GC). Inspection and delivery can be combined at the same time.

2. Formal Acceptance and Other Types of Acceptance

a) German Law

Under the terms of § 12 no. 4 (1) VOB/B, a formal acceptance (*förmliche Abnahme*) must take place if either party so requests. The findings must be set out in a joint written

7 BGHZ 48, 257, 262.

record. If no formal acceptance is agreed or required, informal acceptance is possible. The construction contract often provides for a written declaration of acceptance.

§ 12 no. 5 VOB/B provides for fictitious acceptance (*fiktive Abnahme*) upon expiration of twelve working days after the written notice of completion if no formal acceptance is required.

b) Japanese Law

As presented above, under Art. 23 (1) GC a final inspection by the administrative architect takes place upon completion of the works on the request of the contractor.

Different from the final inspection are statutory inspections to confirm compliance with the requirements under the Building Standards Act (Art. 7 through 7-4) or any other statutory inspection described in the design documents to be conducted by the relevant institutions for which the owner has applied. At the proper time prior to such statutory inspections, the contractor is supposed to confirm that the work has been executed in compliance with the design documents and notify the administrative architect who will then promptly carry out an inspection (Art. 23-2 GC).

Additional inspections may be required in the design documents for portions of the work (Art. 23-3 GC) or for the purpose of partial delivery (Art. 25 GC).

3. Legal Effects of Acceptance

a) German Law

At acceptance the risk passes from contractor to owner (if VOB/B has been agreed, the risk of loss or damage due to objectively unavoidable circumstance passes earlier; see VIII. 1. above) and the contractor's claim to remuneration falls due. At the same time, the limitation period for defects starts to run under the terms of § 634a BGB or § 13 no. 4 (3) VOB/B.

At the time of acceptance, the owner must reserve for himself the right to assert any contractual penalty. If the owner accepts the work without expressly retaining his rights out of defects of which he is aware (§ 640 (2) BGB or § 12 no. 5 (3) VOB/B), then he loses the claim to the rectification of defects, reduction in remuneration, and repudiation of contract.

b) Japanese Law

The aforementioned legal effects as a consequence of acceptance take place at the time of delivery. Then the risk passes to the owner (the exception of loss or damage due to a cause attributable to the owner or force majeure was shown in VIII. 2. above), and the contractor is entitled to the final payment of the contract sum and the limitation period for the claim to remuneration starts to run. The limitation period for defects starts to run at the date of delivery as well (Art. 27 (2), (3), Art. 27-2 (3) GC).

X. Liability for Defects

1. Scope of the Contractor's Liability

a) German Law

Pursuant to § 633 BGB the contractor must procure the work for the owner free of material and legal defects. The work is free of material defects if it is of the agreed quality. To the extent that the quality has not been agreed, the work is free from material defects (1) if it is suitable for the use envisaged in the contract, or else (2) if it is suitable for the customary use and is of a quality that is customary in works of the same type and that the customer may expect in view of the type of work. It is equivalent to a material defect if the contractor produces a work that is different from the work ordered or too small an amount of the work. The work is free of legal defects if third parties, with regard to the work, either cannot assert any rights against the owner or can assert only such rights as are taken over under the contract. The contractor's liability for defect does not require fault.

If the quality has been agreed, it will always be considered a defect if the work lacks the agreed quality. And the assessment of a defect does not depend on whether the lack of the stipulated quality leads to an adverse effect on the use envisaged in the contract or on the customary use.

If the owner gives a guarantee of the quality of the work – which is the strongest form of warranty under German law – the contractor has no possibility to exchange or even limit the owner's legal rights in relation to the guaranteed quality (§ 639 BGB).

The notion of defect under § 13 no. 1 VOB/B compares substantially with that under § 633 (2) BGB.

b) Japanese Law

Art. 634 CC stipulates a straightforward contractor's warranty liability (*ukeoi-nin no tanpo sekinin*) for any defect (*kashi*) in the subject matter of work performed. However, the term "defect" is not defined specifically for contracts for work. Insofar as there is no specific stipulation under the section for contracts for work, the provisions of the section of the sale and purchase contract shall be applied *mutatis mutandis* to contracts for value other than sales and purchase contracts unless the nature of the contract for value does not so admit (Art. 559 CC). The contract for work is such a contract for value. As regards "defects," it is distinguished between material and legal defects and latent defects.

An example for such a defect was a construction contract in which a particularly thick steel for the main pillar was to be used in order to build securely in terms of earthquake resistance. The contractor did not use the steel frame of the agreed-upon thickness for the main pillar construction, thus constituting a defect, even though it was not an important content of the contract, and even though the structure calculation and steel frame that were used for the residence building did not pose safety problems.[8]

---

8 Supreme Court, Judgment, 10 October 2003, in: Hanrei Times 1138 (2003) 278.

On the other hand, no warranty liability of the contractor was recognized where there was subway noise and propagation of the vibrations felt in the building, when no "defect" in the building was admitted, and in particular no violation of the Building Standards Act was confirmed.[9]

A special agreement to exclude the warranty liability seems possible, *arg. ex* Art. 640 CC: Even if the contractor agrees to a special agreement to the effect that the contractor will not be liable for the warranty provided in Art. 634 or Art. 635, the contractor may not be released from the contractor's liability with respect to facts the contractor knew and did not disclose.

2. Owner's Rights in Relation to Defects

a) German Law

Pursuant to § 634 BGB, if the work is defective, the owner's primary claim is to

1. demand rectification (*Nachbesserung*) under § 635 BGB. The owner may assert this claim both before and after the acceptance.
   If the constructor has not rectified the defect within a subsequent time limit, the owner may
2. remedy the defect himself, and demand reimbursement for required expenses (*Ersatzvornahme*) under § 635 BGB, or
3. cancel the contract (*Rücktritt vom Vertrag*) under §§ 636, 323 and 326 (5) BGB, or reduce remuneration (*Minderung*) under § 638 BGB, and
4. demand damages (*Schadensersatz*) under §§ 636, 280, 281, 283, and 311a BGB, unless the constructor proves that he is not responsible, or demand reimbursement of futile expenditure under § 284 BGB.

If VOB/B has been agreed prior to acceptance, defective work must be replaced by the contractor at his cost with defect-free performances (*sofortige Beseitigung*). Along with this, the contractor has to pay compensation for the damage caused by defects for which he is responsible. If the contractor fails to fulfill its duty to remedy the defect, the owner may establish a reasonable period for hin to remedy the defect, declaring that he will withdraw the assignment if the period expires unproductively. After the withdrawal of the assignment, the owner shall be entitled to have the still uncompleted part of the performance executed by a third party at the expense of the contractor, without prejudice to the claims of the owner to compensation of the resulting further damage. The owner shall also be entitled to waive the further execution and to demand damage compensation due to non-performance if the owner no longer has an interest in the work being executed due to the reasons that led to the withdrawal of the assignment (§ 4 no. 7 in conjunction with § 8 no. 3 VOB/B).

---

9 Nagoya District Court, 22 April 2005, in: Hanrei Jihō 1921 (2006) 120.

After acceptance, the owner's rights under the VOB/B correspond to the claims under BGB with some nuances (comp. § 13 no. 5, no. 6 VOB/B). In addition, different from the BGB, a cancellation of the contract because of the defect is not possible.

The claim to damages under § 13 no. 7 VOB/B differs from the statutory claim to damages under § 634 no. 4 BGB in that it presupposes the existence of a significant defect, and consequential damages resulting from the defect only have to be compensated if the defect is based on willful intent or gross negligence by the contractor, or a) on a breach of generally accepted engineering standards, or b) the defect consists of the absence of a specifically warranted quality, or c) if the contractor covered the damage by ensuring his statutory legal liability or could normally have covered it in this way.

b) Japanese Law

Pursuant to Art. 634 (1) CC, if any defect exists in the subject matter of the work, the owner may fix a reasonable period and demand from the contractor repair of such defect. However, the owner may not demand repair if the defect is not significant and excessive costs would be required for the repair. This rule also applies to shipbuilding contracts, where the defect of a ship constructed pursuant to a shipbuilding contract is relatively minor and the repair would require excessive costs.[10]

Under Art. 634 (2) CC, the owner may demand compensation for damages in lieu of, or in addition to, the repair of the defect. In such cases the rule of Art. 533 CC (defense for simultaneous performance) shall apply *mutatis mutandis*. The owner may refuse to pay the amount of remuneration in whole until the contractor pays compensation for damages in lieu of the repair of the defect and shall not be liable for delay in performance, unless it is found to be contrary to the doctrine of good faith to do so in light of, for instance, the significance of the defect or the negotiating attitude of each party to the contract.[11] The owner may set-off his claim for damages in lieu of the repair of defects against the contractor's remuneration claim. The remuneration debt that remains after set-off becomes due on and after the day following the day on which the owner manifested the intention of set-off.[12]

The owner has no cancellation right if the work relates to a building or other structure on land,[13] even if the purpose of the contract cannot be achieved because of the defect (Art. 635 CC). Thus, in most cases the contractor needs to rectify defects in order to not default on the achievement of the purpose of the contract.

---

10 Supreme Court, 20 January 1983, in: Hanrei Times 496 (1983) 94.

11 Supreme Court, 14 February 1997, Minshū 51, 337.

12 Supreme Court, Judgment, 15 July 1997, Minshū 51, 2581.

13 "Other structure on land" (*tochi no kōsaku-butsu*) means according to the social idea that the installation is attached to the ground and dedicated to be used permanently; Supreme Court, 24 September 1964, in: Shūmin 75, 409.

If there is no choice but to rebuild the object of the construction contract due to a significant defect in the building, the owner may claim from the contractor damages in the amount equivalent required for the reconstruction of the building.[14]

The General Conditions confirms the aforementioned Civil Code rules in Art. 27 (1) for works in general and specifically for newly built houses under the Housing Quality Assurance Act in 27-2 (2) GC. Prior to the delivery of the work, if any portion of the work is not executed in compliance with the drawings or the specifications, the contractor shall promptly repair or correct that portion at his own expense in accordance with the instructions of the administrative architect (Art.17 (1) GC).

3. Limitation Periods of Claims Relating to Defects

a) German Law

In a BGB contract, in the case of a building and in the case of a work the result of which consists in the rendering of planning or monitoring services for this purpose, the owner's rights arising out of defects are statute-barred in five years, or after two years in the case of a work the result of which consists in the manufacture, maintenance, or alteration of a property or in the rendering of planning or monitoring services for this purpose (§ 634a BGB). In these cases, the limitation period begins on acceptance.

Under VOB/B, after the acceptance, if no limitation period for warranty claims is agreed in the contract, the limitation period for buildings is two years; for parts of furnace installation in immediate contact with fire and for work on a plot of land, the limitation period is one year. All these periods are calculated from the time of acceptance onward (§ 13 no. 4 VOB/B).

The above-mentioned limitation periods do not apply in cases of deliberately concealed defects. § 634a (3) BGB in conjunction with § 195 BGB provides for a period of three years. This limitation period begins to run at the end of the calendar year in which the claim fell due and the principal obtained knowledge of this.

b) Japanese Law

Pursuant to Art. 638 CC (1), a contractor for a building or other structure on land shall be liable for a warranty against defects in the structure or ground for the period of five years from delivery; however, the period shall be ten years for structures made of stone, earth, bricks, concrete, steel, and other similar structures. (2) If any structure is lost or damaged due to the defects set forth in the preceding paragraph, the owner must exercise the rights under the provisions of Art. 634 CC within one year from the time of the loss or damage. The periods set forth in Art. 638 (1) may be extended by contract so long as they do not exceed ten years (Art. 639 CC).

---

14 Supreme Court, 24 September 2002, in: Hanrei Times 1106 (2003) 85.

The statutory limitation periods are significantly shortened by Art. 27 (2) GC. The period of defect liability is one year in the case of wooden buildings and two years in the case of stone, metal, concrete, or similar buildings, or any other permanent structures or ground from the date of delivery.

If the contract relates to a newly built house that falls under the Housing Quality Assurance Act, the limitation period for defect liability for certain defects in parts of the house will be ten (10) years from the date of delivery (Art. 27-2 (3) GC) and for defects other than those provided therein, same as in Art. 27 (2) GC.

If any such defects have been willfully caused by or are due to gross negligence or material fault on the part of the contractor, the one-year period will be extended to five years, and the two-year period willl be extended to ten years (Art.27 (2) GC).

XI. Delay, Default, Suspension of Work, Contractual Penalty

1. The Legal Consequences of Delay and Default

a) Claims under German Law

Under German statutory law, the failure to carry out work in good time normally does not entitle the owner to withdraw from the contract for work and services. Instead, the owner needs to set a subsequent time limit for performance, and only if the contractor is unable to perform despite the extended deadline does the contractor have the right to termination (§ 323 (1) BGB).

If the contractor has violated a contractual duty with fault, the owner has a claim to damages for delay of performance as specified in § 280 (2) BGB only if the additional requirements of default in § 286 BGB are met, and for damages for non-fulfillment specified in § 281(1) in conjunction with § 280 BGB when the extended deadline has expired unproductively.

If VOB/B has been agreed, in case of delay – called hindrances and interruptions (*Behinderungen* und *Unterbrechungen*) of execution – the right to termination exists if an interruption lasts longer than three months (§ 6 no. 7 VOB/B). A party has a claim for damages if the other party is responsible for the obstacles (§ 6 no. 6 VOB/B). The damages claim differs from that of the BGB because compensation must be paid for the verifiably incurred damage and loss of profit, but only in the event of willful intent or gross negligence.

If the contractor delays the commencement of the work, is in default with the completion, or fails to procure assistance where labor, scaffolding, materials, or components are so insufficient that the execution deadlines obviously cannot be met, the owner may claim, while maintaining the contract, damages in accordance with § 6 no. 6 VOB/B or set a reasonable deadline for the contractor to perform the contract, declaring that he will withdraw the assignment if the deadline expires unproductively (§ 8 no. 3 VOB/B). Additional damages can be claimed.

b) Claims under Japanese Law

Art. 541 CC gives a party the right to rescind the contract if the other party has not performed its obligation, and after it has fixed a reasonable period to demand its performance and no performance is effected within such a period.

If performance has become impossible, in whole or in part, the obligee may rescind the contract; however, this shall not apply if the failure to perform the obligation is due to reasons not attributable to the obligor (Art. 543 CC).

Rescission has the effect that each party shall assume an obligation to restore the other party to that other party's original position (Art. 545 CC).

Under Art. 412 (1) Civil Code, the obligor is responsible for the delay in performance, where a certain time for the performance of an obligation was fixed. Where an obligor fails to effect performance in accordance with the tenor and purport of the obligation, the obligee may demand compensation for damages (Art. 415 CC).

If construction work ends halfway for reasons attributable to the contractor, the owner may claim compensation for damages from the contractor in the amount of the cost required for the construction of the remaining construction work, limited to the amount not exceeding the contract fee amount equivalent to the unconstructed part.[15]

A contractor could not limit the damages caused by special circumstances – he was in delay with the completion of repair of an embankment of a pond for raising eels owned by the orderer when the uncompleted part collapsed under a flood caused by higher-than-normal heavy rainfall and the eels flowed out – even if considered a case of force majeure, when the contractor had no good excuse for his delay.[16]

2. Suspension of Work

If the GC has been agreed, the parties may have a right to suspension of the work as follows:

The owner may at any time, when necessary, suspend the work or terminate the contract if he pays the resulting damages to the contractor (Art. 31 (1) GC).

The owner has the right to suspend the work or terminate the contract and claim damages against the contractor (Art. 31 (2) GC) if

- the contractor failed, without justifiable reason, to commence the work after the date of commencement (lit. a);
- the progress of the work is materially behind the construction schedules without justifiable reason and, accordingly, the contractor will be unlikely to complete the work within the contract time or within a reasonable period thereafter (lit. b);
- the contractor violated the prohibition against subcontracting or executed work not in compliance with design documents despite instructions for correction (lit. c);

15 Supreme Court, 17 May 1985, in: Hanrei Times 569 (1986) 48.
16 Supreme Court, 16 Febraury 1984, in: Shūmin 141.

– the contractor breaches[17] the contract due to any reason and is found unable to achieve the purpose of the contract due to such breach (lit. d).

The contractor (Art. 32 (1) GC) may suspend the work in the events of the owner's delay to make payments, failure to consult, or impossibility because of failure to make the construction area available; because of force majeure or other justifiable reasons; or because the work is materially delayed due to any reason attributable to the owner, and the owner has not corrected the reason within a reasonable period after being notified by the contractor in writing.

3. Contractual Penalty

a) German Law

A contractual penalty requires special contractual agreement. It is incurred if the contractor is in default with the performance of the work or in case of improper performance (§ 339 BGB or § 11 no. 2 VOB/B).

If the damage proven by the owner is greater than the contractual penalty, he is entitled to claim the difference between the proven damage and the contractual penalty as additional damages. This distinguishes the contractual penalty (*Vertragsstrafe*) from the agreement of the so-called liquidated damages (*Pauschalschadensersatz*).

b) Japanese Law

The parties may agree on the amount of the liquidated damages (*baishō-gaku no yotei*) with respect to the failure to perform the obligation. In this case, the court may not increase or decrease the amount thereof. The liquidated damages shall not preclude the demand for performance or the exercise of the cancellation right (Art. 420 (1) and (2) CC).

The Civil Code seems not to stipulate the contractual penalty; instead Art. 420 (3) CC presumes that any penalty (*iyaku-kin*) shall constitute liquidated damages.

Art. 30 GC relates to the delay in performance (*rikō chitai*) and stipulates liquidated damages (*iyaku-kin*) at the annual rate of 10 percent of the contract sum. Art. 30 GC is called *"iyaku-kin"* in Japanese, but the English translation uses the word "liquidated damages." It stipulates that if the contractor fails to deliver the permanent work within the contract time due to any reason attributable to the contractor, the owner may, unless otherwise provided in the construction contract, for each calendar day of delay, make a claim against a contractor for liquidated damages calculated at the annual rate of 10 percent of the contract sum.

---

17 The English translation of lit d. provided by the GCCC Committee could be misunderstood since it translates *"keiyaku ni ihan"* as "defaults under the contract" instead of "breaches the contract."

On the other hand, if the owner fails to complete payments in time, or has delayed advance or part payments, the contractor may make a claim for liquidated damages against the owner calculated at the annual rate of 10 percent on said payments for each calendar day of delay.

XII. VARIATION OF THE CONTRACT TIME

1. German Law

Pursuant to § 6 no. 2 VOB/B, execution periods shall be extended if there is a hindrance preventing the constructor from carrying out the work which is caused by:

(a) any circumstances within the owner's scope of risk;
(b) a strike or lockout ordered by the employers' association at the contractor's operations or at a business working directly for the contractor;
(c) force majeure or other circumstances unavoidable for the contractor.

Weather-related influences during the execution period that could normally be expected when the bid was issued shall not be considered a hindrance.

The contractor must notify the owner in writing without delay, as a precondition of the extension of the time, unless the owner was obviously aware of the fact and of its obstructive effect (§ 6 (2) VOB/B).

2. Japanese Law

The owner may, when necessary, order, inter alia, the contractor to change the contract time (Art. 28 (2) GC) (IV. 2. b) above).

The contractor may submit a claim against the owner for a necessary extension of the contract time when there are reasonable grounds to make a claim for the same, including but not limited to additional or extra work, changes in the work, force majeure, or coordination of the work with other related work (Art. 28 (5) GC).

The GC specifically provides for a right of the contractor to make a claim for a necessary extension of the contract time against the owner

– in certain prescribed cases where the owner is in delay with his obligations or a delay of the contractor's performance is attributable to the owner or the administrative architect's behavior (Art. 20 (2) GC);
– if a statutory inspection was not passed due to reasons not attributable to the contractor (Art. 23-2 (6) GC);
– if adjustment of the contract time becomes necessary due to partial use (Art. 24 (1) GC);
– if the work is suspended (Art. 31 (4) GC);
– if the suspended work is recommenced (Art. 32 (3) GC).

The owner or the contractor may claim for a necessary adjustment to the contract sum if the contract time is changed (Art. 29 (1) lit. b) GC).

XIII. Premature End of the Contract and Termination

1. Owner's Free Right of Termination

a) German Law

Under the terms of § 649 BGB or § 8 no. 1 (1) VOB/B, the owner is entitled to terminate the construction contract at any time until the completion of the work (*Freie Kündigung der Bestellung*). This right of termination has limited practical significance, however, because the contractor retains the claim to the full remuneration agreed, subject to a potential deduction of saved expenses and earnings from the use of his labor during the relevant time, or any earnings he has deliberately failed to make.

b) Japanese Law

Art. 641 CC stipulates that the owner may cancel the contract at any time while the contractor has not completed the work by compensating any damages.

The damages claim of the contractor includes compensation of the overheads that the contractor needed in preparation for the contracted construction and the loss of profits, but does not include consolation money for bad rumors spread by neighborhood inhabitants that allegedly resulted in lost honor and trust.[18]

Art. 31 (1) GC requires a notification of termination to the contractor in writing. In this case, the owner shall indemnify and hold harmless the contractor from and against any loss or damage arising out of or related to the termination.

2. The Right of Both Parties to Extraordinary Termination

a) German Law

§ 6 no. 7 VOB/B confers on both parties an extraordinary termination right in cases in which an interruption of the building work lasts for longer than three months. This applies even if the cause of the interruption comes from the owner's risk sphere.[19] The settlement of accounts shall be made, and, if the contractor is not responsible for the interruption, the costs of vacating the construction site must be compensated.

b) Japanese Law

Such a right of termination seems not to exist under the General Conditions.

3. Owner's Right of Termination

a) German Law

VOB/B also confers on the parties various rights of termination in certain cases of breaches of contract for works and services:

---

18 Fukuoka District Court, 25 November 1983, in: Hanrei Times 525 (1984) 181.
19 BGH, 20 October 2005 – VII ZR 190/02, confirmation of BGHZ 159, 161.

- § 8 no. 2 VOB/B: Insolvency of constructor;
- § 8 no. 3 VOB/B: Fruitless expiration of extended deadline for rectification, § 4 no. 7 VOB/B, or cooperation, § 8 no. 3 VOB/B;
- § 8 no. 4 VOB/B: Unlawful restraint of competition;
- § 4 no. 8 (1) VOB/B: Using a subcontractor without the owner's consent;
- § 5 no. 4 VOB/B: Contractors' default.

b) Japanese Law

The owner's right to termination with reason is stipulated in Art. 31 (2) GC, in particular, if the contractor

(a) is in delay with commencement of the work;
(b) will be unlikely to complete the work within the contract time;
(c) violates the prohibition against subcontracting, or non-compliance with drawings;
(d) commits other violations of contract and is found unable to achieve the purpose of the contract;
(e) receives revocation of contractor's license;
(f) is unable to proceed with the work due to a shortage of funds;
(g) proposes to terminate with no good reason, or
(h) is related to organized crime.

4. Contractor's Right of Termination

a) German Law

The contractor is entitled to a right of termination under the preconditions stipulated in the terms of §§ 642, 643 BGB if the owner has failed to provide the necessary cooperation in the construction of the work.

§ 9 no. 1 (a) VOB/B stipulates the contractor's right of termination with reason in case of the owner's

- default to accept the work;
- default with payment.

b) Japanese Law

Pursuant to Art. 642 (1) CC, in cases where the owner is subject to a ruling for the commencement of bankruptcy procedures, the contractor or the trustee in bankruptcy may cancel the contract.

In this case, the contractor may participate in the distribution of the bankruptcy estate with respect to remuneration for the work already performed and any costs not included in that remuneration. On the other hand, however, the fruits of the work already performed vest in the bankruptcy estate.[20]

---

20 Supreme Court, 23 June 1978, in: Kin'yū Shōji Hanrei 555, 46, Kin'yū Hōmu Jijō 875, 29.

The constructor may claim damages caused by the cancellation only where the trustee in bankruptcy cancelled the contract and intervened in the distribution of the bankruptcy estate (Art. 642 (2) CC).

Furthermore, the contractor may terminate the contract by so notifying the owner in writing, pursuant to Art. 32 (4) GC, if

(a) the work for certain stipulated reasons attributable to the owner or because of force majeure has been suspended for one-fourth of the contract time or two months or longer (Art. 32 (4) lit. a) in conjunction with (1) GC). The contractor may then make a claim for damages against the owner (Art. 32 (6) GC).
(b) the contract sum has decreased by two-thirds or more because the work has been materially decreased by the owner;
(c) the owner defaults and is found unable to perform the contract, or
(d) the owner is related to organized crime, or
pursuant to Art. 32 (5), if the owner is found unable to pay the contract sum due to any reason.

XIV. Security for Claims

1. German Law

The owner normally seeks to ensure the performance of the work and the warranties by means of security to be furnished by the contractor. This usually comes in the form of a bank guarantee provided as security. The warranty security is usually 5 percent of the total sum for the remuneration, and 10 percent of the total sum of the remuneration is not unusual as security for fulfillment of the contractor's performance obligations.
In practice, a guarantee on first demand is often required.

Great importance is attached to the retention of payments as a further form of security. § 641 (3) BGB expressly grants the owner the right to refuse to pay a reasonable part of the remuneration if he is justified in requiring the rectification of a defect.

Under § 648 BGB, the contractor for a building or an individual part of a building may demand that a mortgage over the building plot of the customer be granted for satisfaction of his claims under the contract (*Sicherungshypothek des Bauunternehmers*). If the work is not yet completed, then he may demand that a mortgage be granted for a portion of the remuneration corresponding to the work performed and for expenses not included in the remuneration.

Under § 648a BGB, a contractor for a building, outdoor facilities, or a part thereof may demand a security from the customer for his remuneration (*Bauhandwerkersicherung*). The security may also be provided by means of a guarantee or other promise of payment by a banking institution or credit insurer. To the extent that the contractor has obtained a security for his claim to remuneration, the claim to be granted a mortgage under § 648 BGB is excluded.

A further instrument of security for the contractor is provided by the Act on Security for Construction Claims. The person who receives construction money is obliged to use such money for the satisfaction of persons or enterprises who/which participate in the construction of a building on the basis of contracts of employment, contracts for work and services, or supply contracts, and it seems fair to compensate him for damages if there is no negligence on his side.

2. Japanese Law

a) Each Party Has the Defense for Simultaneous Performance (Art. 535 CC)

In international construction projects in Japan, the usual methods for securing the contractor's claims to remuneration are advance payments – sometimes secured by a refund bond or letter of guarantee[21] – and irrevocable letters of guarantee unconditionally payable to the contractor on his first written demand and valid until 30 days after the contractual delivery is executed and completed by the contractor.

b) The Act for Ensuring Execution of Defect Warranty Liability

In the case of a newly built house under the Housing Quality Assurance Act, housing suppliers who provide new houses must secure financial resources that cover the cost to repair a defect, which will help home owners correct the defect with the minimum cost. Through this mechanism, the repair cost for a defect found in a house within ten years from the handover will be covered even if the housing supplier cannot fix the problem due to bankruptcy or other reasons. A housing supplier has to choose which measure he takes in order to secure financial resources in case of the occurrence of a defect between "taking out housing insurance" and "deposit of set amount of money." The Act also requires that a housing supplier explain his method to the homeowners when constructing or selling a new house.

SUMMARY

The comparison of substantial provisions of the construction contract presented similarities and differences in both jurisdictions. The Japanese Civil Code provides few provisions on construction contracts. In practice the standard General Conditions are widely used to provide the parties of a construction contract with detailed terms and conditions. The GC fairly balances the interests of the parties and provides flexible rules to apply in all situations that typically occur or may occur in construction projects. The general

21 Osaka High Court, 26 February 1999, Kin'yū Shōji Hanrei 1068, 45, regarding an L/C governed by English law issued by a Japanese bank in connection with a shipbuilding agreement.

contractor contract is usually a lump-sum fee contract, and the work to be delivered is defined by the design documents and terms and conditions. There is however, flexibility as regards alterations of the work performance and adjustment of price where it becomes necessary to alter the work and where the contract price becomes inappropriate.

The remuneration becomes due at delivery of the permanent work and is subject to a limitation period of three years. The General Conditions shift the risk from the contractor to the owner if the work is damaged or destroyed by force majeure prior to delivery. In the event of impossibility not attributable to any party, the contractor loses his remuneration claim and is relieved from the obligation to deliver the work. The contractor warrants the absence of any material, legal, and latent defects. Liability for defects may be excluded by agreement to some extent, but this is not popular and is unavailable in the case of willful concealment of the defect. The General Conditions have relatively short limitation periods for defects of one year for wooden buildings and two years for other permanent structures on land, except for new houses that fall under the Housing Quality Assurance Act, which mandates ten years. In construction contracts the obligee can already exercise his rights before the occurrence of a default when risk of a default exists. Liquidated damages rather than contractual penalty clauses are used in construction contracts. Enumerated contract time variation, suspension, and termination rights for both parties are provided by the General Conditions. Advance payments and bank guarantees to secure payment claims are usually used. English translation of terms should always be double-checked against the Japanese texts to avoid misunderstandings.

ZUSAMMENFASSUNG

Aus der Sicht des deutschen Rechts untersucht der Beitrag wesentliche Bestimmungen der in Japan üblichen Allgemeinen Geschäftsbedingungen des Bauvertrags. Durch Gegenüberstellung der sachlichen Vorschriften zum Bauvertrag wurden Gemeinsamkeiten und Unterschiede in beiden Rechtsordnungen deutlich gemacht. Im japanischen Zivilgesetz finden sich nur wenige Vorschriften zum Bauvertrag. In der Praxis werden die Bau AGB verwendet, um den Parteien eines Bauvertrags detaillierte Geschäftsbedingungen zur Verfügung zu stellen. Diese Bau AGB stellen einen angemessenen Interessenausgleich zwischen Besteller und Unternehmer dar und enthalten Regelungen, mit denen flexibel auf die unterschiedlichsten Situationen, die in Bauprojekten auftreten oder auftreten können, reagiert werden kann. Der Generalunternehmervertrag ist üblicherweise ein Pauschalpreisvertrag, und das zu liefernde Werk ist vor allem durch die Leistungsbeschreibung definiert. Jedoch besteht Flexibilität in Bezug auf Änderungen von Leistung und Preis, wenn Leistungsänderungen notwendig werden oder der Preis unangemessen wird. Die Vergütung wird mit der Lieferung des fertigen Werks fällig und verjährt in drei Jahren. Die Bau AGB verlagern das Risiko des zufälligen Verlusts oder Schadens vor Lieferung aufgrund höherer Gewalt vom Besteller auf den Unternehmer. Bei von keiner Seite zu vertretender Unmöglichkeit der Leistung verliert jedoch der Un-

ternehmer seinen Vergütungsanspruch und wird von der Leistungspflicht befreit. Der Unternehmer gewährleistet die Freiheit von sämtlichen Sach- und Rechtsmängeln sowie von versteckten Mängeln. Ein Haftungsausschluss ist zwar möglich, wird praktisch aber eher selten akzeptiert und ist unwirksam bei arglistigem Verschweigen. Die Bau AGB haben gegenüber dem ZG relativ kurze Verjährungsfristen für Baumängelansprüche, nämlich ein Jahr bei Holzhäusern und zwei Jahre bei anderen baulichen Anlagen, mit Ausnahme von neuen Häusern, die unter den Housing Quality Assurance Act fallen, die zehn Jahre beträgt. Der Gläubiger im Bauvertrag kann bereits vor Eintritt eines Verzugsfalls seine Rechte geltend machen, wenn die Gefahr eines Verzugs besteht. Pauschalschadensersatz und keine Vertragsstrafen sind in Bauverträgen üblich. Die Bau AGB enthalten eine Aufzählung von Vertragszeitänderungs-, Unterbrechungs- und Kündigungsrechten beider Parteien. Vorauszahlungen und Bankgarantien zur Sicherung von Zahlungsansprüchen sind üblich. Bei englischen Übersetzungen sollte zur Vermeidung von Missverständnissen auf die Übereinstimmung mit dem japanischen Originaltext geachtet werden.