

## Client Alert

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## Civil Code amendments affecting real estate transactions - Volume Four

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In this alert, we highlight some of the key amendments to the Civil Code that will impact construction and other service agreements.

These are agreements categorized as "contracts for work" (*ukeoi keiyaku*), where one party (the "contractor") promises to complete certain services or work, and the other party (the "client") promises to pay a certain fee in exchange for the completed services or work (Article 632 to Article 642 of the Amended Civil Code).

### Partial Fee Payment for Uncompleted Services / Work

Under the Amended Civil Code, even if the contractor does not complete the promised services / work, they will nonetheless be able to request partial payment of the contract fee depending on the value of the service or work provided to the client.

Under the current Civil Code, unless separately agreed between the parties, the contractor may not request partial fee payment before it completes the promised services / work<sup>1</sup>. However, it has long been recognized by legal practitioners and commentators that even if the services / work is not completed, in some cases, partially completed product can still be viewed as beneficial to the client. Indeed, construction contracts in the Japanese market often provide for a series of fee payments based on specific milestones before completion of the construction project, and such provisions have been upheld as valid by the courts.

The Amended Civil Code follows prevailing market practice and contract interpretation to clarify that such partial fee payments are valid if (i) the contractor cannot continue to provide the services / work for reasons not attributable to it; or (ii) the contract for work is terminated before completion of such services / work<sup>2</sup>.

### From Warranty against Defects to Warranty against Non-Conformity

Similar to amendments to the rules applicable to sale and purchase agreements<sup>3</sup>, the rules applicable to contracts for work under the Amended Civil Code have also been updated to replace the customarily used concept of a "warranty against defects" (*kashi-tanpo sekinin*) with the concept of a "warranty against non-conformity" (*keiyaku futekigo sekinin*) pursuant to the Amended Civil Code.

For further information  
please contact

TOK-RealEstate  
[@bakermckenzie.com](mailto:@bakermckenzie.com)

Baker & McKenzie  
(Gaikokuho Joint Enterprise)

Ark Hills Sengokuyama  
Mori Tower 28F  
1-9-10, Roppongi, Minato-ku  
Tokyo 106-0032, Japan  
Tel + 81 3 6271 9900  
Fax +81 3 5549 7720  
[www.bakermckenzie.co.jp](http://www.bakermckenzie.co.jp)

<sup>1</sup> Current Article 632

<sup>2</sup> New Article 634

<sup>3</sup> New Article 565



This new "warranty against non-conformity" gives clients under contracts for work wider remedies than was previously available for breach of a "warranty against defects", including the right to request completion of the work or maintenance, the right to claim damages, the right to terminate the relevant contract for work (including construction contracts), and the right to request a reduction of construction fee<sup>4</sup>.

Please see Volume 2 of this alert series for details of the "warranty against non-conformity" in the context of sale and purchase contracts.

## Termination Right under Building Construction Contracts

Under the current Civil Code, a client under a contract for the construction of a building or facility has no right to terminate the contract even if the building or facility is found to have a very serious and substantial defect<sup>5</sup>. This result has been criticized by the market, and in some cases the courts awarded damages amounting to the cost of demolishing the defective structure and constructing a new building, effectively giving the client a remedy analogous to a right of termination.

The Amended Civil Code in effect addresses these criticisms and allows the client the right to terminate any type of construction contract, even if the contract is for the construction of a building or facility. We believe this amendment meets market needs and provides a realistic solution to the problems faced by clients under the existing rules.

## Simplified Statute of Limitation Rule

Under the current Civil Code, a client wanting to claim against a contractor for breach of a "warranty against defects" generally must file the claim against the contractor in court within one year from delivery of the services / work under an ordinary contract for work, within five years in the case of a building construction contract, and within ten years if the building is made of concrete, stone or steel (but not timber)<sup>6</sup>.

This rule has been widely viewed as placing too much of a burden on claimants given the time normally needed to prepare and file claims in court.

The Amended Civil Code, however, requires clients merely to give the contractor notice that the services / work does not conform within one year from the time the client becomes aware of non-conformity. In addition, the Amended Civil Code simplifies the complex statute of limitation rules that apply under the current Civil Code.

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<sup>4</sup> The Amended Civil Code provides a new right to terminate even building construction contracts and a new right to request reduction of construction fees.

<sup>5</sup> Current Article 635 proviso

<sup>6</sup> Current Article 637 and Article 638