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This issue covers the following topics:

■ CAPITAL MARKETS

New Court Ruling in the Kyoto District Court on Capital Raising by way of Third Party Allotment

I. Summary

On March 28, 2018, the Kyoto District Court ruled in favor of a shareholder's petition that a listed issuer company cease an offering of its new shares by third party allotment as the offering was being conducted by an "extremely unfair method", even though this offering was approved by a resolution at the company's shareholders' meeting.

II. What is Third Party Allotment?

A "third party allotment" is a method of offering shares of a joint stock corporation (in Japanese, kabushiki kaisha) in Japan where the board of directors determines the parties to whom the newly authorized shares will be allotted ("Allottees"). Under the Japanese Companies Act, the issuer company's board of directors is permitted to issue new shares, which are authorized in its articles of incorporation but have not been issued at the time, on terms determined by the board of directors; provided however that authorization at a shareholders meeting is also necessary when the issue price of the offering is a "specially favorable" price.

The decisive factor in a third party allotment that distinguishes it from a public offering under the Companies Act is that the issuer determines the Allottees who can be purchasers of offered shares. In comparison to a public offering, a third party allotment offering is especially important for companies whose financial condition is unsound or whose share price is not attractive enough to make a public offering practically feasible. Historically, third party allotment offerings in Japan have been conducted among business partners or with financial institutions as a tool to establish a capital relationship underlying a business collaboration or to rehabilitate the issuer company.

III. Safeguarding Existing Shareholders against Third Party Allotment

Under the Companies Act, if existing shareholders are likely to suffer a disadvantage under either of the two following scenarios, the shareholders may demand that the issuer company cease the offering of its shares, regardless of whether it is third party allotment or a public offering:

(i) the offering violates applicable laws and regulations or the company's articles of incorporation; or

(ii) the offering is conducted by an 'extremely unfair method'.

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In practice, the existing shareholders seek such an injunction typically based on the following two reasons: (i) the issue price of an offering is a "specially favorable" price; and (ii) the offering is conducted by an "extremely unfair method" as the primary purpose of the offering is maintaining the management's control.

As described above, the Companies Act provides that the issuer company's board of directors may issue new shares on its own authority, unless the issue price of such offering is a "specially favorable" price. However, "specially favorable" price is not defined in the Companies Act. If the issue price is a "specially favorable" price, such offering needs to be approved by a resolution at a shareholders' meeting where the directors should explain the "necessity of making the offering at a specially favorable price". In addition, such "necessity of making the offering at a specially favorable price" shall be provided in the convocation notice which needs to be sent to shareholders two weeks or more before the date of the shareholder meeting. As a result, if the offering of shares at a "specially favorable" price is conducted without the resolution at the shareholders' meeting, such offering would be in violation of the Companies Act in relation to the procedure for offering shares.

Similarly, an "extremely unfair method" is not defined in the Companies Act. The Japanese courts, however, appear to have adopted a so-called "main purpose rule." Under this rule, the Japanese courts will look to see what is the primary purpose of the share offering, including, for example, capital raising or maintaining management's control. In previous cases, the courts have determined that an offering is not conducted by an "extremely unfair method" when the primary purpose of the offering is raising money, even though, as a result, the offering would be effective in maintaining the management's control.

IV. Key Takeaway from the Ruling

(i) Factual background

The important facts in relation to this ruling are as follows:

-Before the issuer company (the "Issuer") determined to offer new shares to certain affiliate individuals or corporations, a certain shareholder company (the "Shareholder"), who eventually filed for the injunction, had requested that the Issuer form business collaboration between them. At the same time, the Shareholder proceeded to purchase shares of the Issuer in the secondary market and, as a result, became the second largest shareholder of the Issuer. The largest shareholder of the Issuer was the Issuer's management.

-The Issuer rejected the offer from the Shareholder regarding the business collaboration and requested it to stop raising its shareholding.

-The Issuer announced the planned offering but the issue price was set far below the most recent market price of its shares. In addition, the Issuer sent a convocation notice to its shareholders. However, the convocation notice did not include the continued offer about business collaboration from the Shareholder or the reason for the issue price, which was considered "specially favorable".

-Immediately after the Issuer announced the planned offering, the Shareholder offered to the Issuer its proposal of equity financing, in which the Shareholder proposed that the issue price would be equal to the recent market price. However, the Issuer rejected this proposal insisting, among others, that the business collaboration with the Shareholder would have a material adverse impact on the corporate value of the Issuer and the planned offering would be more beneficial for the shareholders in the mid-to-long term despite the lower issue price.

-In response to the rejection by the Issuer, the Shareholder distributed written material to other shareholders that explained the detail of its proposal and requested that the other shareholders give proxies to the Shareholder with respect to the shareholder meeting that was to be held to approve the planned offering.

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  by Akemi Suzuki, Tomohiro Sekiguchi (co-author)

-Following the distribution of these materials by the Shareholder, the Issuer also sent written material its shareholders to explain its position. However, this material was distributed less than two weeks before the date of the shareholder meeting.

-The offering of the shares, as planned by the Issuer, was eventually approved at the shareholder meeting.

(ii) Ruling by the Kyoto District Court

In this case, the Kyoto District Court adopted the "main purpose rule" in accordance with the previous court rulings. The court concluded that the main purpose of the offering planned by the Issuer was to reduce the shareholding of the Shareholder. The rationale behind this conclusion was that the issue price of the offering was far below the market price and there was no reason why the offering could not be conducted with a more favorable issue price. The court pointed out that the fact that the Issuer rejected the proposal by the Shareholder of the equity offering with a higher issue price implied that the Issuer intended to dilute the shareholding of the Shareholder. With respect to the approval at the shareholder meeting, the court said that this approval may not validate this offering and emphasized the fact that the counter offer from the Shareholder was not disclosed to the shareholders before the Shareholder distributed its written material for proxies. Furthermore, eventual disclosure by the Issuer of the counter offer was made less than two weeks prior to the date of the shareholder meeting, while the Companies Act requires the Issuer's convocation notice to be issued at least two weeks prior to the date of the shareholder meeting and include information relevant to the "necessity of making the offering at a specially favorable price".

(iii) Comment

This case is a lower-court ruling and, as such, will need to be tested in other similar cases before it can be generalized. However, while the prima facie position appears to remain that approval at shareholders' meeting is valid justification for a proposed share offering, it is very important to recognize that, depending on the factual circumstances, even with shareholder approval, an offering may be subject to an injunction order on the grounds that such an offering is conducted by an "extremely unfair method".

■ Real Estate / Hospitality

Overview of the "Minpaku" Law

I. Introduction

Japan has been experiencing a boom in inbound tourism in recent years on the back of a number of various factors, including a depreciating of the Japanese yen, promotion of Japan's historical attractions and a relaxing of visa requirements for tourists. It is also expected that the demand for accommodation in Tokyo will continue to rise significantly in the lead up to the 2020 Olympics. These circumstances have resulted in an increase in the number of hotels and accommodation facilities, but there still remains significant unsatisfied demand in the accommodation market. In order to meet this demand, private lodging services (in Japanese, minpaku) have been introduced by foreign service providers, such as Airbnb. However, in Japan under the Hotel Business Act, a hotel license is required to provide accommodation services for fee-paying guests. Private lodging services (e.g., a room rented by one individual to another individual for a certain fee through the internet) could be within the scope of the Hotel Business Act and therefore require a hotel license. The legal position of private lodging services has been subject to debate over the last couple of years as it has increasingly attempted to fill the gap in the accommodation market.

In order to achieve a balance between relaxing the strict licensing requirements and maintaining robust regulations over the operation of private lodging services, the Private Lodging Business Act (Minpaku Law) was enacted on 9 June 2017 and came into effect on June 15, 2018.

II. Overview of the Private Lodging Business Act

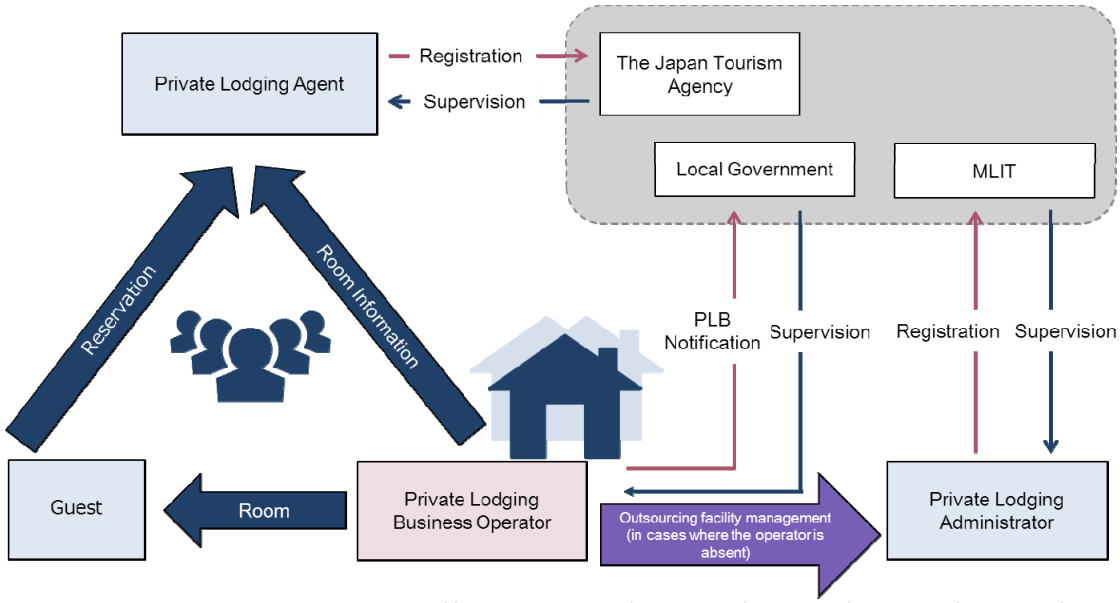
While the Hotel Business Act is a basic law regulating all forms of accommodation services, including private lodging services, the Private Lodging Business Act specifically addresses the regulation and operation of private lodging services. The Private Lodging Business Act provides the following regulatory features:

(i) Regulation of minpaku operators

The Private Lodging Business Act regulates the role of three (3) key players in the operation of a private lodging service: the private lodging business operator; the private lodging administrator; and the private lodging agent.

Private lodging business operators are typically landlords or lessees that wish to accommodate a fee-paying guest in their residential premises. Private lodging administrators are required to be retained if the private lodging business operators are not physically present in the premises to accommodate a guest. Since the role of private lodging administrator is to manage the premises and the facilities therein, a property management company will typically fulfil this role. Private lodging agents (e.g., Airbnb) serve as broker for private lodging services between guests and the private lodging business operators.

The typical structure of the three main actors is shown below:



http://www.mlit.go.jp/kankocho/minpaku/overview/minpaku/law1_en.html

(ii) No license

While it has not been clear under the Hotel Business Act whether a hotel license is required to provide private lodging services, the Private Lodging Business Act makes it clear that a hotel license is not required to conduct private lodging services. However, prior to engaging in private lodging services, a private lodging business operator must submit a notification ("PLB Notification") to the relevant local government authority. By removing the licensing criteria and instead only requiring the submission of the PLB Notification, the regulators aim to ease the operating burden of private lodging service providers.

Separately, the Private Lodging Business Act requires that a private lodging administrator and a private lodging agent are registered with the Ministry of Land, Infrastructure, Transport and Tourism.

(iii) Maximum number of operating days

Under the Private Lodging Business Act, a private lodging business operator cannot provide private lodging services for more than 180 days per year. Since under the Private Lodging Business Act, a day is counted from noon on the first day to noon on the following day, the private lodging business operator can provide the services for up to 180 nights and 360 days in Japan. This is one of the weaknesses of providing private lodging services compared with operators licensed under the Hotel Business Act, which does not have any limitation on the number of operating days.

(iv) Prevailing regulations by local governments

The Private Lodging Business Act allows a local government to limit the area and period that an private lodging business operator can provide private lodging services, to the extent reasonably required to avoid excessive noise and a deterioration of the local living environment. For instance, Kyoto City has implemented a municipal ordinance that a private lodging business operator within a certain exclusive residential area can only provide services from January 15 to March 16; whereas there is no similar limitation in other areas of Kyoto City.

(v) Neighborhood protection

In order to prevent harmful effects on the surrounding areas, a private lodging business operator is obligated by the Private Lodging Business Act to quickly and properly respond to complaints and inquiries made by a neighbor. Furthermore, a guideline published by the Japan Tourism Agency and relevant governmental authorities on December 26, 2017 (the "Guideline") recommends that, although not mandatory, a private lodging business operator explain to neighbors in advance its intention to provide private lodging services.

(vi) Special arrangement for inbound tourists

A private lodging business operator must ensure that there are instructions in foreign languages on: (i) how to use the facilities in the room; (ii) transportation for traveling; and (iii) contact information in case of emergency events, such as a fire or an earthquake.

(vii) Size

The Private Lodging Business Act stipulates that only rooms that are at least 3.3 square meters or larger can be used for private lodging services. It should also be self-contained with a kitchen, bathroom, toilet and washstand facility.

(viii) Fire safety

In principle, a private lodging business operator is required under the Fire Service Act to install appropriate emergency lighting and fire protection equipment, and establish evacuation routes. However, there is an exemption for private lodging business operators who are living on the premises and providing a room to guests that is less than 50 square meters in size. In this regard, the requirements under the Fire Service Act may be seen as prohibitively onerous on landlords or lessees, who wish to provide private lodging services but do not fall under the exemption.

(ix) Guest records

A private lodging business operator is obliged to record the basic information (e.g., name and nationality) of all guests in a lodging registry book. The private lodging business operator is required to report the number of guests and these other details to the local government every two months.

III. Comment

According to a paper published by the Japan Tourism Agency, 10,270 PLB Notifications had been issued as of October 12, 2018. While this is approximately four times the number of PLB Notifications that had been issued as of July 15, 2018 when the Private Lodging Business Act came into effect, it is not as many as had been expected.

One of the main complaints and reason for the slow uptake is the complication of the PLB Notification process. The Private Lodging Business Act and the related regulations require an applicant to submit many detailed documents along with the PLB Notification (e.g., evidence that the private lodging services are allowed in a strata title building). Furthermore, although the Private Lodging Service Act does not require a hotel license for the private lodging services, some local governments request that an applicant consults with them before submitting the PLB Notification. This pre-screening grants the local government a greater level of control over the PLB Notification process as well as creating an additional layer of red tape.

In order to address this issue, the Japan Tourism Agency and other relevant governmental authorities issued a paper to local governments on July 13, 2018 encouraging local governments to (i) review and consider whether the volume of documents that an applicant has to submit with the PLB Notification can be decreased; and (ii) not cause an increase in the applicant's burden by requesting they attend a pre-consultation meeting.

The trends surrounding home-stay lodging services in Japan are changing rapidly. In order to keep pace, the governmental authorities regularly issue guidance papers outlining their interpretation of certain provisions of the Private Lodging Business Act and the related regulations. New entrants should take care to review the provisions of the Private Lodging Business Act as well as the guidance papers issued by the governmental authorities from time to time.

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