THE INTERNATIONAL HOTEL LAW REVIEW

Editors
Mark Abell and Karen Friebe

THE LAWREVIEWS

THE INTERNATIONAL HOTEL LAW REVIEW

Reproduced with permission from Law Business Research Ltd
This article was first published in November 2020
For further information please contact Nick.Barette@thelawreviews.co.uk

Editors
Mark Abell and Karen Friebe

THE LAWREVIEWS

PUBLISHER
Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGER
Joel Woods

SENIOR ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS
Olivia Budd, Katie Hodgetts, Reece Whelan

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Janina Godowska

SUBEDITOR
Martin Roach

CHIEF EXECUTIVE OFFICER
Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC2A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-468-2

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

AZB & PARTNERS

BIRD & BIRD

CMS VON ERLACH PONCET AG

MCCARTHY TÉTRAULT LLP

NAGASHIMA OHNO & TSUNEMATSU

TAY & PARTNERS

CONTENTS

PREFACE

The hotel sector has evolved. A lot.

It is now a far cry from the coaching inn and the 'Mom and Pop' motel, and those who wish to own a hotel no longer have to be involved in its operation. There is no need to put a mint on the pillow, fill the ice buckets or even visit the property. If an investor so chooses, a hotel can remain a line on a balance sheet and no more. This apparent cut in complexity is not, however, reflected in the sector's legal demands.

What enabled this hands-off approach for the most hands-on of sectors was the move from asset-heavy to asset-light, a trend that began in the 1960s with the franchising of the Holiday Inn brand. This gained traction in the United States with the popularisation of real estate investment trusts, and in Europe with the adoption of various investment models, including sale and leaseback.

The largest hotel companies embraced the chance to sell assets and use them to fund expansion. In 2018, Hilton was one of the last groups to shed its assets: making good on a three-way split announced two years earlier, spinning off its timeshare business and moving 70 of its owned hotels into a REIT. Simplifying the businesses would, it was hoped, result in a higher net valuation multiple.

Part of the motivation behind selling off the family jewels was the need for valuation simplicity. Another was the growing appetite for the sector from investors – an increasing number of them being institutions, whose structure prevented participation in operations.

With companies such as Marriott International and Hilton freed from the rigours of ownership, focus turned to the rapid growth of their brand stables, embracing a wave of branding that has permeated every aspect of commercial life. At the last count, Marriott International had more than 30 brands, illustrating the expanded scope of the hotel sector, moving past those motels and reaching deep into luxury resorts, serviced apartments and even private residences. As the customer asserts the right to 'their stay their way', the number of flags available to owners will only multiply, with the new model less a stable of separate entities and more a big happy family, united by a loyalty programme.

When it came to franchising, size mattered. Marriott International, Hilton Worldwide, Wyndham Hotels & Resorts, Choice Hotels International and Intercontinental Hotels Group – the top five franchisors by total room count in the United States – collectively represent 82 per cent of the total franchised branded rooms according to STR and JLL Research.[1]

Branding a hotel may look as simple as branding a chocolate bar, but the expansion of franchising out of the US was merely the start of the options for hotel owners, and the

1 https://www.jll.co.uk/en/trends-and-insights/investor/why-more-hotels-are-owned-by-franchisees.

number of players involved in each hotel has expanded with the number of brands. These players now include third-party operators, asset managers, franchisors and franchisees, managers, operators and, of course, owners in their many forms. Unlike a chocolate bar, a hotel night is a passing commodity: if you don't sell that room tonight, it, and its potential revenue, no longer exist.

Regional variances have grown within the hotel stack. Leases are popular in Germany, but much less so in other countries. It is a minefield for those companies that want to act globally but are forced to act locally. Owners and their demands also vary. The family office looking for a multi-generational hold has very different aspirations to the private equity house looking to flip an asset in five years.

A brand is no longer just reassurance that the shower will work and the breakfast will be the same. The customer wants more; wants experience; wants something unique backed by the security of the standard. Delivering this has become ever-more demanding.

There are those who buck the trend, including CitizenM in the Netherlands and Whitbread in the United Kingdom. They see their strength in the ability to control all aspects of the company, see assets not as a dead weight, but as the solid core that they can rely on and the source of their ability to act nimbly.

The considerations in every contract have expanded exponentially. With more brands come more concerns from owners about competition on their patch. Differences between flags must be defined to protect against accusations of cannibalisation and brand owners playing favourites with their new toys. The cost of the brand has grown past marketing; there are issues around investment and refreshing the offering. Just because an unseen person in HQ 5,000 miles away wants a new type of mattress as a new brand standard, is the owner required to pay for it? And a new neon sign? And a coffee machine in every room? The brands' insatiable appetite for expansion, and to enter into amenity wars with their rivals, threatens owners' returns and often leads to conflict.

Marketing a property is an art and a skill that comes at a cost, and distribution is now a hotel department in its own right. Hotels have been taught to fear the high fees of the online travel agents, but owners have complained that the response of the globally branded players – to fight fire with loyalty programmes – has also come at a cost. When the asset is properly aligned, a hotel can deliver glorious rewards as well as a wonderful stay.

Aligning the parties has become the priority for those helping to build the relationship and create an asset which works. Hotels have edged their way into the mainstream asset classes, joining retail, office and residential. With that has come increased scrutiny from investors and the need for thorough contracts between parties – not just a handshake at the bar. The skill involved in this search for balance has never been more demanding, nor the depth of knowledge required greater.

Mark Abell and Karen Friebe
Bird & Bird
October 2020

Chapter 8

JAPAN

Makoto (Mack) Saito and Shinichiro Horaguchi[1]

I INTRODUCTION

Japan has been experiencing a boom in inbound tourism in recent years. According to the statistics published by Japan National Tourism Organisation, while the number of foreign tourists visiting Japan had been less than 10 million before 2013, in 2019 more than 31.8 million foreign tourists visited Japan. There are multiple background factors for such dramatic increase such as a depreciation of the Japanese yen, promotion of Japan's historical attractions and the relaxation of visa requirements for foreign tourists.

These circumstances have resulted in significant demand of new hotel rooms and thus hotels have been one of the most active real estate sectors in Japan in the past half-decade.

Japanese government has been promoting inbound tourism. In 2018, an amendment to the Hotel Business Act (Act No. 138 of 1948) was enforced, updating the hotel-related regulations. Also, the Private Lodging Business Act (Act No. 65 of 2017) was enacted to officially permit private lodging under proper regulations.

II MARKET ENTRY

Generally, there are no restrictions on foreign investors investing in, owning, leasing or operating hotels in Japan. Under the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949), there are various notification requirements depending on types of the businesses and transactions but in most cases involving investment from foreign investors, post facto notification requirement would apply in connection with hotels.

Further, when a foreign company intends to carry out transactions continuously in Japan not through its subsidiary or branch in Japan, it must register its representatives in Japan and at least one of such representatives in Japan must be a person whose address is in Japan.

III LEGAL STRUCTURES

All of the typical structures for hotel operations (i.e., (1) sole proprietorship, (2) lease, (3) hotel management agreement and (4) franchise agreement) can be seen in Japan. Although leases would be the most prevailing structure, hotel management agreements and franchise agreements have become very common especially in cases where international hotel operators are involved.

1 Makoto (Mack) Saito and Shinichiro Horaguchi are partners at Nagashima Ohno & Tsunematsu.

In developing a hotel or converting a building used for other purpose into a hotel, the location of the hotel must meet the zoning requirements under the City Planning Act (Act No. 100 of 1968). The building must also meet various building requirements including those under the Building Standard Act (Act No. 201 of 1950), Fire Service Act (Act No. 186 of 1948) and local regulations. Architects and other engineers normally take care of the compliance to such zoning and building regulations.

Hotel business requires a licence under the Hotel Business Act. In lease structures, lessees have to obtain hotel business licences. In the case of hotel management agreement and franchise agreement, although owners, rather than managers or franchisors, normally obtain licences, but consultation with the competent local government agency is recommendable as this depends on policy of local government and details of the actual arrangement.

IV LEASES

Real property lease is one of the unique areas in Japanese laws. The Act on Land and Building Leases (Act No. 90 of 1991) heavily protects rights of lessees, regardless of whether lessee is individual or a legal entity. Especially in a standard building lease, a lease term is, in general, renewable, and a lessor may refuse such renewal only when there are justifiable grounds for the lessor.[2] Since Japanese courts tend to strictly interpret such justifiable grounds, practically it is difficult for a lessor to refuse a renewal of a standard building lease and as a result a lessee substantially has a right for renewal regardless of the terms and conditions provided in the relevant lease agreement. Similarly, lessors' termination rights have been restrictively recognised by Japanese courts regardless of the terms and conditions provided in the relevant lease agreements.

With respect to the renewal, the Act on Land and Building Leases allows 'fixed-term 'building leases that shall not be renewed, which is recognised as another type of lease under the Act on Land and Building Leases.[3] Such fixed-term building leases have become common in commercial leases, including hotel leases. However, termination rights of lessors are still subject to strict scrutiny by Japanese courts in the case of fixed-term building leases.

Another important right granted under the Act on Land and Building Leases is the right to request decrease or increase in rent. When the building rent becomes unreasonable, as a result of an increase or decrease in tax and other burdens relating to the land or the buildings, as a result of the rise or fall of land or the building prices or fluctuations in other economic circumstances, or in comparison to the rents on similar buildings in the vicinity, the parties may, notwithstanding the terms and conditions of the relevant lease agreement, request future increases or decreases in the amount of the building rent. In fixed-term building leases, the parties may remove such statutory right for rent decrease or increase by agreeing upon specific terms and conditions for future rent revision.

2 Under Japanese laws, a land and a building on the underlying land are regarded as different properties (i.e., building does not constitute a part of the underlying land). Land leases and building leases are subject to different rules under the Act on Land and Building Leases. The following explanation focuses upon building leases as building leases are more frequently used in the hotel sector.

3 It is possible for the parties to enter into a new lease agreement starting immediately after the expiration of the fixed-term building lease agreement.

Although it is possible to register a building lease to the competent legal affairs bureau, such registration is rarely used because, even without such registration, the building leasehold right is deemed perfected against any transferees of the building once the building is handed over to the lessee.

V INTELLECTUAL PROPERTY AND BRANDING

Generally, Japan adopts first-to-file trademark system. Accordingly, it is important and very common for hotel brand holders to register trademarks that may be used in Japan. Since there is an online database for searching trademarks[4] in Japan, in the case where hotel brand operators intend to introduce a new logo in Japan, it would be helpful for them to check through the online database to see whether there is an existing trademark registration similar to the contemplated new logo.

VI DATA AND HOTEL TECH

Compliance with regulations regarding personal data protection has become one of the key issues in hotel sector. Under the Act on the Protection of Personal Information (Act No. 57 of 2003), a business operator handling personal information shall not deal with personal information without obtaining in advance a principal's consent beyond the necessary scope to achieve a utilisation purpose specified by the business operator handling personal information. Further, a business operator handling personal information shall not provide personal data to a third party without obtaining in advance a principal's consent, except for certain cases permitted by the Act. As a hotel business operator normally falls within the definition of business operator handling personal information under the Act, it must comply with such requirements as well as other requirements under the Act and relevant guidelines in handling guest information. Especially, in cases of a hotel management agreement or franchise agreement, it is important to ensure such compliance in sharing guest information among the owner or franchisee, operator or franchisor and their affiliates. It should be noted that if a business operator handling personal information provides personal data to a third party in a foreign country, the Act generally requires the business operator handling personal information to obtain a principal's consent to the effect that he or she approves the provision to a third party in a foreign country.

Recently, many hotel operators use internet based services in connection with reservations and promotions among other matters. Such internet based services are often subject to the Act on Specified Commercial Transactions (Act No. 57 of 1976), which regulates, among other matters, mail order sales (e.g., online sales) and the Act on Regulation of Transmission of Specified Electronic Mail (Act No. 26 of 2002), which regulates commercial emails for marketing purposes. Furthermore, if the service contains a prepayment for future goods or services, regulations on the prepaid payment instruments under the Payment Services Act (Act No. 59 of 2009) may apply.

4 https://www.j-platpat.inpit.go.jp/t0100.

VII FRANCHISING OF HOTELS

Hotel franchising is often seen in Japan, but there is no law specifically regulating hotel franchise business, although the Civil Code (Act No. 89 of 1896) applies as it regulates the rights and obligations in general.

The Medium and Small Retail Commerce Promotion Act (Act No. 101 of 1973) (the MSRCPA) regulates 'chain businesses', in which an entity or individual, as a franchisor, sells or acts as an agent to sell products to small and mid-size retailers and provides the retailers with management guidance. The typical example is a franchise convenience store. However, since hotel franchising mainly concerns the provision of knowhow, guidance and the right to use a brand to franchisees, which is unrelated to the sale of products, the MSRCPA does not apply.

From the perspective of competition law, the Guidelines Concerning the Franchise System (the Franchise Guideline) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) (the Antimonopoly Act) regulate the solicitation of potential franchisees by franchisors and the terms and conditions of franchise agreements. The Franchise Guideline requires franchisors to disclose sufficient and accurate information in soliciting prospective franchisees, otherwise the franchisors' solicitation activities could be deemed deceptive customer inducement, which is illegal as it falls under the category of unfair trade practices. The Franchise Guideline also regulates franchise agreements between franchisors and franchisees. According to the Franchise Guideline, it is acceptable for franchisors to impose certain restrictions on the franchises to be managed and operated by franchisees if it is necessary to provide a clear market position for franchisors. However, if franchisors unduly restrict the franchisees' hotel operations, it could constitute trading on restrictive terms[5] under the Antimonopoly Act. Whether or not franchisors unduly restrict franchisees is abstract and open to debate.

VIII HOTEL MANAGEMENT AGREEMENTS

Hotel management agreements are widely utilised in Japan especially for transactions with international hotel operators. However, there is no law specifically regulating such agreements, although the Civil Code applies as it is applicable to the rights and obligation of owners and operators in general.

From a Japanese law perspective, one of the issues with hotel management agreements is the employment structure for hotel senior executives such as general managers. Where an owner directly employs a general manager, it would be less of an issue. However, if the general manager employed by the operator is seconded to the owner, the Act for Securing the Proper Operation of Worker Dispatching Undertakings and Improved Working Conditions for Dispatched Workers (Act No. 88 of 1985) (the Worker Dispatching Act) and the Employment Security Act (Act No. 141 of 1947) must be taken into consideration. The Worker Dispatching Act prohibits an unlicensed employer from having its employee work for a third party under the supervision of the third party. The Employment Security Act

5 Trading on Restrictive Term means trading with another party on conditions which unjustly restrict any trade between the said party and its other transacting party or other business activities of the said party (Section 13 of Designation of Unfair Trade Practices (Fair Trade Commission Public Notice No. 15 of 18 June 1982).

also regulates worker dispatching business, in which an employer causes its employee to work for a third party under the supervision of the third party. If (1) secondees such as general managers are employed by not only operators but also owners or (2) secondees are employed by operators only and are not subject to the supervision and direction of owners, the Worker Dispatching Act does not apply (in the case of item (2) above the Employment Security Act does not also apply). However, even if the employment relationship set forth in item (1) above exists between the secondees and owners, the Employment Security Act, rather than the Worker Dispatching Act, may apply but there are certain exceptions to such application where the secondment is carried out for the purpose of (a) securing employment opportunities at related companies, (b) providing management or technical guidance, (c) vocational development or (d) personnel exchange among group companies. The secondment of a hotel's senior executives may usually fall under item (b) above.

There is no standard form of hotel management agreement in Japan. It is common for an operator to prepare a draft hotel management agreement based on its own format.

IX FINANCING

Owners typically raise funds for the construction or purchase of a hotel using debt and equity capital. Debt is procured on a corporate finance or asset finance basis.

Where lenders lend owners money for the construction or purchase of a hotel, it is common for owners to create a mortgage on the hotel in favour of lenders. Where the loan is accelerated due to the owner's default, the lender may foreclose on the mortgage, dispose of the hotel and apply the proceeds from such disposal to the repayment of the loan. Additionally, the loan agreement between a lender and owner typically provides that the owner shall comply with all hotel transaction agreements and also obtain the prior written consent of the lender for certain important matters such as a change of the budget or business plan or material indebtedness. Additionally, lenders often have the right to change operators if the existing operators breach the hotel transaction agreements or certain financial milestones are not achieved.

International hotel operators typically require owners to enter into a non-disturbance agreement with them and any lender to whom a mortgage or other security interest is granted over the hotel as part of the financing of the hotel. The non-disturbance agreement is intended to protect operators by requiring lenders to recognise the existence of the hotel management agreements, and the operators' tenure thereunder in the event of enforcement by lenders against owners. This may also include restrictions on loan-to-value ratios and a requirement that any incoming purchaser of the hotel following an enforcement event also continue to be bound by the hotel management agreements. However, in the case of a lease structure where a lease has priority over the mortgage, the lease will survive, and be unaffected by, the foreclosure of the mortgage. Namely, in such case, the non-disturbance agreement will not be mandatory as the operator will be secured under the lease right with priority over the mortgage.

It is common for foreign investors to use one of the two major real estate financing structures called the GK-TK structure and TMK structure in making investments in real estate in Japan. Generally, these structures have been designed to achieve tax-pass through treatments as well as procuring debt-financing. Since these structures are mainly tax driven, consultation with a tax adviser is essential in structuring.

X EMPLOYMENT LAW

While the number of hotels and accommodation facilities has rapidly increased, many hotels face a personnel shortage, which has resulted in overtime work for employees. The Labour Standards Act (Act No. 49 of 1947) provides that, as a general rule, the statutory maximum number of normal working hours for any employee is 40 hours a week and eight hours a day, excluding breaks. Employers may extend working hours up to a certain upper limit when employers enter into a labour management agreement with a union that is constituted by a majority of its employees or, if there is no such union, the representative of a majority of the employees in the workplace.[6] If employers extend working hours beyond the statutory maximum hours with the labour management agreement, employers must pay an additional overtime payment for work during such hours at a certain rate in addition to the normal wages per work hour.

Hotels are susceptible to market volatility. One of the options for dealing with such volatility is to adjust the number of hotel personnel according to the volatility. However, in Japan, an employer may dismiss an employee only for reasons that are objective, logical and reasonable, and a dismissal without objective and logical grounds in accordance with society's standards will be deemed invalid as an abuse of rights. Since Japanese courts tend to strictly define what is objective, logical and reasonable, practically speaking, it is difficult to dismiss employees.

XI DISPUTE RESOLUTION AND MANAGEMENT

Generally, Japanese corporations prefer litigation in court to arbitration, and litigation is the most popular dispute resolution procedure even in the hotel industry. However, international hotel operators usually prefer to choose arbitration as a means of dispute resolution. Whether the parties will choose litigation in court or arbitration is one of the typical negotiation points.

Currently, hotel management agreements and franchise agreements are frequently utilised, especially for deals with international hotel operators, but the number thereof is still less than that of hotel lease agreements. According to public information, there are few lawsuits over newly emerging hotel management agreements and franchise agreements.

On the other hand, there are several cases over hotel lease agreements. One of the noteworthy issues is rent increase or decrease request allowed under the Act on Land and Building Leases, as explained above. There are several rent deduction cases involving super luxury hotels.

XII OUTLOOK

The covid-19 pandemic has caused a sharp fall in international tourist arrivals in Japan during the first quarter of 2020 like other countries. A critical factor driving the hotel industry recovery is a reduction in the number of new covid-19 cases. In the event of a prolonged need for social distancing and a persistent occurrence of new covid-19 cases, the recovery would be slow but the domestic and close-to-home travel would return first. As covid-19 vaccines are

6 The application of this upper limit to small and medium-sized employers is postponed until 1 April 2020.

currently being developed and travel restrictions are gradually being lifted in many countries, the international tourism demand is also expected to return to pre-crisis level in the next few years.

Appendix 1

ABOUT THE AUTHORS

MAKOTO (MACK) SAITO

Nagashima Ohno & Tsunematsu

Makoto (Mack) Saito is a partner at Nagashima Ohno & Tsunematsu. His practice focuses on real estate transactions. He advices many international hotel operators and investors in various hotel projects in Japan. He earned an LLB from the University of Tokyo in 1999 and an LLM from University of Michigan Law School in 2006.

SHINICHIRO HORAGUCHI

Nagashima Ohno & Tsunematsu

Shinichiro Horaguchi is a partner at Nagashima Ohno & Tsunematsu. He has been involved in the area of real estate transactions including hotel development projects in Japan. He has represented not only an owner but also an operator side in many hotel deals. He received an LLB and LLM from Kyoto University in 2003 and 2005 respectively, and an LLM from Duke University in 2012.

NAGASHIMA OHNO & TSUNEMATSU

JP Tower, 2-7-2 Marunouchi, Chiyoda-ku
Tokyo 100-7036
Japan
Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
makoto_saito@noandt.com
shinichiro_horaguchi@noandt.com
www.noandt.com

an LBR business

ISBN 978-1-912228-80-5