

THE INTERNATIONAL  
HOTEL LAW  
REVIEW

SECOND EDITION

**Editors**

Mark Abell and Karen Friebe

THE LAWREVIEWS

# THE INTERNATIONAL HOTEL LAW REVIEW

SECOND EDITION

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# CONTENTS

PREFACE.....	v
<i>Mark Abell and Karen Friebe</i>	
Chapter 1	FRANCHISING IN THE HOTEL SECTOR..... 1
<i>Mark Abell</i>	
Chapter 2	AUSTRALIA..... 19
<i>Vince Baudille and Adrian Rodrigues</i>	
Chapter 3	CANADA..... 33
<i>Trevor Lawson</i>	
Chapter 4	CHINA..... 52
<i>Sven-Michael Werner and Grace Zhao</i>	
Chapter 5	DENMARK..... 68
<i>Søren Narv Pedersen, Marie Grønlund, Mogens Dyhr Vestergaard and Claudia Vindbjerg Mortensen</i>	
Chapter 6	FRANCE..... 81
<i>Alexandre Vuchot, Ariane Mole, Anne-Charlotte Le Bihan, Bertrand Levy, Djazia Tiourtite and Boris Martor</i>	
Chapter 7	GERMANY..... 93
<i>Elie Kaufman, Joseph Fesenmair and Benjamin Karcher</i>	
Chapter 8	INDIA..... 109
<i>Hardeep Sachdeva and Priyamvada Shenoy</i>	
Chapter 9	ITALY ..... 121
<i>Antonella Ceschi</i>	

Chapter 10	JAPAN .....	134
	<i>Makoto Saito and Shinichiro Horaguchi</i>	
Chapter 11	POLAND .....	141
	<i>Marcin Świerżewski, Kuba Ruiz, Maciej Georg, Marta Kwiatkowska-Cylke, Mateusz Dubek and Paulina Grotkowska</i>	
Chapter 12	SINGAPORE.....	154
	<i>Lorraine Anne Tay and Audrey Lim</i>	
Chapter 13	SWITZERLAND .....	169
	<i>Sibylle Schmyder</i>	
Appendix 1	ABOUT THE AUTHORS.....	181
Appendix 2	CONTRIBUTORS' CONTACT DETAILS.....	195

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Having written his doctoral thesis on 'The Law and Regulation of Franchising in the EU', he has acted as an expert to the WIPO and WTO on franchising and is co-editor of the world's leading legal periodical in his field of practice, the *International Journal of Franchising Law*.

He is a member of the IBA Franchise Committee and the ABA Franchise Forum. He is a frequent speaker at both legal and commercial conferences around the world on franchising and multichannel strategies.

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He is currently advising the Committee on Internal Market and Consumer Protection of the EU Parliament on potential new franchise legislation, and is the author of its recent report 'Legal Perspective of the Regulatory Framework for Franchising in the EU'.

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Karen is a London-based partner in the international real estate group with many years' experience in real estate transactions. She also leads the international hotels, hospitality and leisure team, specialising in the acquisition, development and disposal of all types of hotels, from budget to luxury and in the negotiation of hotel management agreements.

Working with a skilled team, she is involved in buying, selling and developing hotels. She also negotiated hotel franchise agreements and hotel management agreements and related

documents such as IP licences and technical services agreements. In recent years, Karen has successfully concluded a number of high-profile M&A transactions and hotel management agreements in London and globally.

She is listed in the legal directories as an expert in the hotels and leisure sector. In addition, she is a regular panellist at industry conferences such as the International Hotel Investment Forum.

She is one of the founder members of Real Estate Balance, which works to address the gender imbalance in the real estate sector. It brings people together from all areas of real estate to help address gender inequality in the sector.

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# JAPAN

*Makoto Saito and Shinichiro Horaguchi<sup>1</sup>*

## I INTRODUCTION

Japan has been experiencing a boom in inbound tourism in recent years prior to the covid-19 pandemic. 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, and (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.

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<sup>1</sup> Makoto 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.<sup>2</sup> 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.<sup>3</sup> 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.

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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<sup>4</sup> 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. 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.

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<sup>4</sup> <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 MSRPCA) 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 MSRPCA 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<sup>5</sup> 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 also

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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).

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. 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 caused a sharp fall in international tourist arrivals in Japan during 2020 as in other countries. A critical factor driving the hotel industry recovery is a reduction in the number of new covid-19 cases and development of covid-19 vaccines. 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 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.

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