

JAPAN

Hotel Management Agreements



Introduction



One cannot discuss the evolution of hotel management agreements (HMAs) without first talking about the separation of hotel ownership and hotel operations; a transformation of the major chains' business models, more commonly known as an "asset light" strategy. Today the form taken by hotel operators in HMAs is an important factor in the effective working of the market in hotel investment. DLA Piper's Hospitality and Leisure Sector Group has negotiated HMAs for a myriad of different clients across the H&L landscape (owners, investors, operators (both branded and white label) and lenders) in all of the world's key jurisdictions.

Many consider hotel management agreements to be borne out of a modified lease for the Hong Kong Hilton back in 1963, and the main terms included in it underpin most HMAs to this day. All major chains today have, to one degree or another, expanded nationally and internationally through a combination of franchise and management, and all have their own "form" or template agreements. In summary, over the last few years, we have found that trends that started as a result of the financial crisis of the last decade have continued to develop. In many markets the advent of recession made operators more risk averse. Traditionally HMAs were a means to limit operators' exposure to fixed rental payments when revenues were dropping. In less developed markets, even with a degree of economic recovery, operators have continued to use HMAs in this way. In more developed markets, such as Spain and the United Kingdom, we have seen increased complexity in agreements, a symptom of owners becoming more knowledgeable and seeking more control and input on the operation of their hotel, although owners continue to take the lion's share of commercial risk in developments.

Another important factor, as with any real estate investment, is the attitude of those who are providing the money, be it equity or debt. Leases were the traditional mainstay of hotel developments and indeed Germany remains a country where hotel deals are commonly based around leases. However, as investors have started to see the increased returns from ownership, the boom in arrangements like ground leases and other market changes is essential to have an understanding of investors and be able to work with them in a scenario of increasingly complex legal arrangements.

Key contacts



Matt Duncombe

Partner, Global Co-Chair,
Hospitality and Leisure
DLA Piper UK LLP
T +44 113 369 2948
matt.duncombe@dlapiper.com
[View bio](#)



Jo Owen

Partner, Global Co-Chair,
Hospitality and Leisure
DLA Piper UK LLP
T +44 207 796 6293
jo.owen@dlapiper.com
[View bio](#)



Harriet Lipkin

US Co-Chair, Hospitality and
Leisure
DLA Piper LLP (US)
T +1 202 799 4250
harriet.lipkin@dlapiper.com
[View bio](#)



Bradley Levy

US Co-Chair, Hospitality and
Leisure
DLA Piper LLP (US)
T +1 312 368 4093
bradley.levy@dlapiper.com
[View bio](#)



Japan

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General

Are Hotel Management Agreements (HMAs) common in the jurisdiction?

Yes, particularly in the upscale and luxury market. Competition in the market has led certain operators to couple management agreements with investments in the underlying asset.

If not HMAs, what are the alternatives / what is commonly used?

Lease agreements are well entrenched in the market, often as a result of owners' financing requirements. Hybrid leases – leases that contain elements of management agreements – are common between local owners and international hotel operators and allow the parties to share the risks and benefits of hotel operations, including by pegging rental fees to revenue, gross operating profit (GOP), or a combination of the two. Franchise agreements have gained popularity with some international hotel operators in recent years, but are normally reserved for owners (or operators) with successful track records in operating a hotel.

Is it common or usual for the HMA to be governed by (i) local laws; (ii) the laws of one of the parties' country of incorporation; or (iii) an alternative jurisdiction?

It depends on each case. Japanese laws are sometimes used in HMAs.

Are there any significant or unusual points to note in respect of tax on HMA payments in the jurisdiction?

HMA payments are usually subject to consumption tax (*shohi-zei*) which is 10%.

Term and termination

Is there a standard contract period of an HMA?

Yes, 20-30 years for luxury and upscale brands; 15-20 years for budget and midscale brands.

Is the term usually fixed? Are early exit or similar options included (contractual or implied)?

Yes, the term is usually fixed. Early exit options are normally limited to contract and specifically owners' breach of the HMA or operators' failure to achieve performance tests for several years. Implied termination rights (for convenience) are not common.

Is it usual to include fees / liquidated damages for early termination?

Yes. Liquidated damages are generally enforceable in Japan and are often agreed (especially for the benefit of the operator) in an HMA. Amounts will vary widely across brand and location (there are cases where liquidated damages equivalent to one to three times management fees for the remaining contract period are provided for). Some owners and operators prefer not to stipulate a pre-determined amount, however, and allow damages to be determined by the courts or arbitral panel, as the case may be.

What is the usual position in respect of renewal?

Renewal is usually by the mutual written agreement of the parties. A renewal period depends on several factors, eg the initial period, performance of the hotel in the initial period.

Fees

Is there a standard fee structure for HMAs (eg base + incentive)?

Fees vary depending on brand, operator and hotel location. The standard position is for a base fee pegged to total revenue and an incentive fee pegged to GOP.

What other fees and charges are there (such as royalties, accounting, marketing, license fees, etc.)?

License fees (normally a percentage of total revenue), centralized services fee (based on the services provided), and marketing service fees (based on either gross room revenue or total revenue).

Are owners typically required to set aside funds for fixtures and fittings?

Yes. This may be on a fully notional or partially notional basis. This is a point which, among others, the parties negotiate heavily.

Performance and operations

What is the usual standard imposed on an operator in respect of the operation of the hotel?

The standard is normally to operate the hotel in line with the standards of other hotels in the same class in Japan. Most operators will hold themselves out as independent contractors, and accordingly any fiduciary duties owed to the owner should be set out in the HMA.

What performance measures are commonly used in the jurisdiction?

Either or both of the GOP Test and the RevPAR Test. The GOP Test, where achievement is measured against the hotel's budgeted profitability, is most common.

Is an operator or owner guarantee common in the jurisdiction?

An operator guarantee is uncommon; these guarantees are sometimes seen for prime properties, but even then it is common for operators to have clawback rights (ie to be able to deduct payments made under the guarantee against future surplus profits). An owner performance guarantee is commonly sought when the owning entity under the HMA does not hold title to the real estate.

What is the usual position in respect of employees? With whom does the liability for the employees sit?

The owner is usually liable for the employees whether or not it is the employer of hotel employees. Some operators employ senior management of the hotel.

Is it usual to have a non-compete clause, eg that no other property with that brand can open within a certain radius?

Yes. The area and the term depend on each case. Thoughts from the competition law perspective would also be necessary.

Who is responsible for insurance?

The owner. The operator will seek to obtain operational insurances (in the owner's name and as operational expenses).

Does the HMA give rights in real estate in the jurisdiction?

No.

Does the HMA need to be recorded against the property, if this is possible in the jurisdiction?

No. Record of an HMA against the property is not possible.

Where financing is taken, is it standard to obtain a Non-Disturbance Agreement (NDA) as part of a management or lease agreement?

It depends on each case. But, it is not common in Japan for a bank to agree to an NDA.

What other agreements usually sit alongside an HMA in the jurisdiction?

Variation of a (brand) license agreement and technical consultancy agreement, and depending on the operator, a centralized services and marketing agreement.

Transfers and assignments

What are the standard rights / restrictions in respect of transfer / sale of the hotel?

Operators will require consent to any change in the ownership structure, and consent can be withheld for a number of reasons, including if the owner fails the operator's compliance checks or is deemed a competitor of the operator.

When a managed hotel is sold (either asset or share deal), is it usual in the jurisdiction that either the Operator's consent is required for the sale, or that the hotel may only be sold if the HMA transfers with the hotel?

Usually the operator's consent is required for a sale of the hotel. Most operators will require a termination fee if the owner is allowed to terminate the HMA upon sale to a third party. Often this termination fee is an amount equal to the average annual management fees earned multiplied by the remaining years under the HMA.

Do HMAs commonly include a right of first refusal for the operator to purchase the hotel?

No, it is not common.

Is it usual to include provisions which enable the sale of the property with vacant possession ie without the brand?

Sale with vacant possession would usually be subject to the operator's consent. There will be an exit fee (or compensation fee) owed to the operator should an owner exit from the HMA in such cases.

Key contacts



Mitsuharu Kataoka

Partner

DLA Piper Tokyo Partnership

T +81 3 4550 2936

mitsuharu.kataoka@dlapiper.com

[View bio](#)

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