What Foreign Investors Must Know About Japanese Casinos

Law360, New York (May 8, 2017, 5:13 PM EDT) -- Foreign investors interested in the hospitality and tourism sectors and related opportunities in real estate, retail and finance have welcomed legislation passed late last year in Japan to open the world’s third-largest economy to legalize casino gaming as part of integrated resorts (IR) that include other facilities, such as hotel, retail and convention facilities. Industry experts believe that Japan is positioned to achieve up to $25 billion per year in gaming-related revenue, which would make Japan’s gaming industry roughly four times larger than that of Las Vegas and almost as large as Macau’s. However, the new legislation is general and the legal and regulatory regime will only come into focus once implementing legislation is enacted, which is expected to occur by year-end.

This article highlights major issues expected in upcoming laws and regulations, and provides tips to those interested in participating in casinos and IRs.

Overview of Current Legislation and Implementation

The Dec. 15, 2016 Act on Promoting Development of Areas for Specified Integrated Resort Facilities (“Promotion Act”) makes clear that casinos will only be allowed as part of IRs located in authorized localities. However, the act provides little guidance, instead specifying that “necessary legislative measures [must] be taken” to enact regulations regarding implementation of IRs (such implementing legislation, the “Implementation Act”). On March 17, 2017, the Japanese Cabinet announced the creation of a “Promotion Headquarters,” headed by Prime Minster Shinzo Abe, to discuss and draft the Implementation Act and related regulations. Reports indicate the Cabinet aims to submit and pass the draft Implementation Act in the next extraordinary session of the Japanese Diet this fall, meaning that the Implementation Act could come into effect by the end of this year.

Key Elements of IR Legislation

1. Limited Legalization of Gambling

The Promotion Act provides for the creation of a limited number of IRs which can house a casino facility along with other business and entertainment facilities. The
act does not specify a limit on the percentage of IR floor space that can be devoted to casinos, but the expectation in Japan appears to be that there will be such a limit, perhaps as low as 3 percent. Japan is predicted to follow the Singapore model of seeking IRs that derive a significant amount of their revenue from nongaming activities the Macau model, where 90 percent or more of revenues reportedly come from gaming.

Permitting casinos only as part of IRs reflects the general approach to gambling in Japan, where gambling is prohibited under the penal codes but certain gambling-like operations, such as horse and motor boat races and government lotteries, are exempted under specific laws. The very popular pachinko and pachi-slot (pinball and slot-type machines) operate in a legal “gray zone” where gambling prohibitions have not been applied to their operation. Industry and legal experts expect that the Implementation Act will exempt authorized IRs from the prohibition against gambling, subject to robust licensing requirements and scrutinized monitoring. Here, non-Japanese operators with a proven track record in other jurisdictions may have operational advantages, as the Japanese government has been reviewing and is expected to adopt elements of the regulatory regimes in jurisdiction such as the U.S., Singapore and Korea.

2. Countermeasures to Problem Gambling

Japan has yet to develop significant measures to address problem gambling (compulsive gambling), even though the government a recently estimated that more than 5 million people in Japan — mainly pachinko players — are “addicted” to gambling (as defined more broadly than for purposes of criminal enforcement). The Promotion Act mandates that the Implementation Act must include robust restrictions and requirements for entrants to casinos and a cap on the number of IRs. A supplemental resolution states that systems designed for government levies on casinos or IR operators must carefully consider countermeasures to problem gaming. The Promotion Act does not address whether the Implementation Act will include a casino entry tax or prohibitions against certain categories of locals entering casinos (as used in Singapore).

3. Anti-Money Laundering

Another key concern in Japan regarding casinos has been their potential for use in money laundering. Under the Promotion Act, in addition to robust requirements for operators, the Implementation Act must provide strict measures for anti-money laundering that comply with the Financial Action Task Force Recommendations. The supplemental resolution made in connection with the passage of Promotion Act also requires the government to be extremely cautious in assessing whether to permit a so-called “junket” system (marketing agent, financier and servicer), which has widely been viewed as connected to money laundering in certain jurisdictions.

4. Procedural Steps

The Implementation Act is expected to include detailed procedures regarding selection of areas where IRs will be permitted and a process for approving their operators. The Promotion Act contemplates a two-step selection process, whereby the national government designates a certain number of “IR Areas” from among local government applicants. Then, the designated local governments will choose operators, who must in turn be authorized by the national government.

Key Tips for Market Entrants
1. Determine the Entrance Strategy

IRs of the type operated in Las Vegas, Singapore and elsewhere are massive developments and IRs to be developed in Japan’s largest cities may cost $5-10 billion each to develop. Operating such massive facilities and their related hotel, retail and convention businesses, as well as operating casino businesses subject to a comprehensive regulatory regime, requires tremendous expertise and know-how possessed only by a limited number of major international gaming companies, none of which are based in Japan. On the other hand, developing such facilities will likely require Japanese companies with local expertise and resources and in certain cases, to own or control real estate needed for given IRs. As a result, it is generally expected that most or all IRs will be developed and operated by collaborations or joint ventures between experienced global gaming companies (all of whom have for years been cultivating contacts in Japan) and major Japanese construction, real estate or other enterprises. Finding the right partners and structuring the right relationships among them will be critical for all involved.

Given the anticipated scale of IRs, in addition to the leading roles of major global gaming companies and local Japanese developers, there will be opportunities for participating in IR development and operation by hotel, retail, entertainment, tourism and other companies as well as debt and equity investors in them. In anticipation of the 2020 Tokyo Olympics and the development of IRs, and also as a result of growing general interest in Japan as a vacation destination, the tourism industry is already rapidly changing and developing in Japan and thereby creating opportunities for foreign investors.

2. Importance of the Local Government

There has been much speculation about which areas in Japan will be approved for IRs, how many will be approved and whether there may be a staged approach, e.g., with approvals being given initially to two or three areas and in later years expanded to others if the initial “IR experiment” has gone well. It is widely expected that Tokyo, Osaka and Yokohama will be the leading candidates to be approved as areas where IRs may be developed, and some of the leading global gaming companies have already released “mock up” plans for what major IRs in these locations might look like. There has also been much interest expressed by governmental and/or private parties in the development of IRs in less populous areas, including Hokkaido, Okinawa, Nagasaki, Miyazaki and others, and discussion about whether strict limitations on casino floor space may undermine the commercial viability of IR’s in such areas. With the exception of Osaka, which has been especially proactive in advocating and preparing for IRs, the political dynamics in most areas appear fluid, as there are both parties keenly interested in developing IR and others who are antagonistic to, or at least concerned about, having casinos in their areas (whether given areas should apply to be integrated resort areas is expected to be a major issue in some local election campaigns).

Conclusion

Although the Promotion Act contemplates the two-step selection process discussed above, in practice it is critical for IR developers and operators to begin discussions with candidate local governments in advance, because the applications by local governments are expected to include information regarding the proposed business operators of integrated resorts within their local areas and related business plans. Moreover, after submission of the application, it is expected that substantive collaborative work between the local government and the potential operator will be required in order to be designated by the national government as an IR Area. As this process develops, it can be expected that the discussions, proposals and business planning will expand beyond the major gaming companies and their principal local partners in Japan and extend to parties providing hotel, convention, retail, entertainment and
other facilities as well as related financing, security, compliance and other services. There should be myriad opportunities for foreign parties to participate in the development and operation of IRs in Japan.

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