

Recent Formulation of Guidelines for random type sales of NFT

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Recently, Japan's Council for Sports Ecosystem Promotion ("**C-SEP**")¹ established guidelines for both NFT random sales and NFT secondary distribution markets.^{2,3} These guidelines are welcome additions to the Japanese NFT landscape, as simultaneous presence of NFT random type sales services (sales methods in which the NFT provided is randomly determined, including package sales, Gacha sales, package sales, reveal sales and random generation sales) and secondary distribution markets has seen experts and political circles alike holding discussions on its legality in relation to gambling. Indeed, on 26 April 2022, the Liberal Democratic Party's Headquarters for the Promotion of a Digital Society released an "**NFT Whitepaper**,"⁴ which states that "the relevant ministries and agencies should clearly demonstrate that at least certain types of business do not constitute gambling," that "the development of rules from the perspective of protecting consumers who purchase NFT through random type sales and secondary distribution markets should be discussed separately," and that "guidelines are expected to be developed by business operators based on the positions of the relevant ministries and agencies."

Accordingly, private industry associations developed both the herein introduced guidelines to promote sound development of NFT business by presenting legal considerations regarding certain types of transactions and by outlining points that the target business operators should note and avoid. While the contents of both guidelines are similar to a considerable extent, there are some differences in terms of scope of application, etc. In this article, both guidelines are outlined, along with their backgrounds and discussion of their points that relevant business operators should bear in mind.

¹ C-SEP aims to create new revenue sources through sports DX such as sports data utilization, sports betting, fantasy sports, NFT and sports tokens, and to form and promote an ecosystem by building a fund circulation system for promotion of sports and solution of social issues. As of 24 October 2022, a total of 92 companies are participating. See <https://www.c-sep.jp/>

² On 12 October 2022, C-SEP and several blockchain industry associations jointly released "Guidelines for Random Type Sales of NFT" (the "**Joint Guidelines**"), drafted by Nishimura & Asahi members Kaku Hirao and Hironori Inagaki, among others.

³ On 20 September 2022, C-SEP released the "Guidelines for the Parallel Establishment of an NFT Package Sales and Secondary Distribution Market Utilizing Sports Content" (the "**C-SEP Guidelines**").

⁴ "Digital Nippon 2022: The Challenge of New Capitalism through Digital Technology," Appendix 1, "NFT White Paper: Japan's NFT Strategy for the Web 3.0 Era" (the "**NFT Whitepaper**") prepared by its NFT Policy Project Team.

1. The C-SEP Guidelines

(1) Background of Formulation

Recent years in the U.S. have seen a rise in popularity of Dapper Labs, Inc. (“**Dapper Labs**”) service, “NBA Top Shot,”⁵ which provides both NFT packages sales⁶ and a secondary distribution market therefor.⁷ However, in Japan, concern has arisen that platforms like NBA Top Shot and its services may constitute the crime of gambling (Article 185 and Article 186(1) of the Penal Code). Due to such concern, many business operators hesitate to offer NFT package sales and a secondary distribution market in parallel. This hesitation has seriously hindered the development of business utilizing NFT in Japan’s sports industry. In addition, the rights and rules for returning revenue from NFT sales and the secondary distribution market to sports organizations and players, including the method of returning revenue to retired or transferred players and the legal nature of revenue from the secondary distribution market, are not well organized, which makes it difficult for the business operators to deploy secondary distribution services using players’ portraits, etc. as NBA Top Shot.

In light of this situation, along with respectively exchanging opinions with blockchain and gaming industry associations, C-SEP hold a series of discussions in a working group (including the Sports Industry Office of the Commerce and Service Industry Policy Group of the Ministry of Economy, Trade and Industry (the “**METI Sports Industry Office**”) among others).⁸ Whether a service similar to NBA Top Shot (a service that ties the sale of NFT packages with the provision of a secondary distribution market) constitutes gambling was originally a discussion topic at the “Study Group on Rights for the Expansion of Sports Content and Data Business” jointly held by the Ministry of Economy, Trade and Industry and Japan Sports Agency, where Professor Takashi Hashizume of the University of Tokyo Graduate Schools for Law and Politics was a guest speaker, and where the topic was discussed based on his opinion paper titled “Issues Concerning Gambling Crimes.”^{9, 10} Furthermore, in order to look at the issue in greater depth, C-SEP invited Professor Hashizume to the said working group and continued discussions. Recently, C-SEP published “Guidelines for the Parallel

⁵ NBA Top Shot is a service that sells packages called “Moments,” which include random NFTs of NBA players’ playing videos, etc., and Dapper Labs also operates a secondary distribution market. Some Moments of popular players have been resold in the secondary distribution market for as much as 10 million yen or more.

⁶ A type of NFT sales in which multiple NFTs are randomly combined and sold with the contents unrevealed.

⁷ A secondary distribution market operated and managed by a business corporation that operates a NFT packages sales.

⁸ The full working group comprises C-SEP board member companies, external experts (including several NFT business persons affiliated with professional sports organizations and academics), the Sports Industry Office of the Commerce and Service Industry Policy Group of the Ministry of Economy, Trade and Industry (“METI Sports Industry Office”) as observers, and the C-SEP Secretariat.

⁹ https://www.meti.go.jp/shingikai/mono_info_service/sports_content/005.html

¹⁰ Nishimura & Asahi also has submitted an opinion letter titled “The Provision of Services Similar to NBA Top Shot and Whether or not It Constitutes the Crime of Gambling” by Kaku Hirao, Hironori Inagaki, and Masayuki Obata (https://www.meti.go.jp/shingikai/mono_info_service/sports_content/pdf/005_04_00.pdf). This issue also was introduced in our previous newsletter (Kaku Hirao, Hironori Inagaki, Masayuki Obata, “Consideration of Whether or not the Random Type Sales and Concomitant Establishment of Secondary Distribution Market Using NFT Constitutes Gambling Crime - In Light of NFT White Paper (Draft)” (Nishimura & Asahi Sports Business Law Newsletter as of April 1, 2022)).

Establishment of an NFT Package Sales and Secondary Distribution Market Utilizing Sports Content” (the “C-SEP Guidelines”) on 20 September 2022,¹¹ compiling the results of all those discussions.

(2) Overview

A. Purpose

The C-SEP Guidelines provides a legal framework for the provision of NFT package sales utilizing sports content and parallel secondary distribution markets, that among other things helps to identify whether such combination constitutes a gaming crime, and for profit returns from the secondary distribution market, and presents a business model that can be deployed in Japan with consideration for consumer protection, by which the C-SEP Guidelines aim to achieve the sound development of NFT business in the Japanese sports industry and the appropriate circulation of funds to sports organizations and athletes.

B. Scope of Application

The C-SEP Guidelines are applicable to all services in Japan that have both package sales and a secondary distribution market for NFT, such as images using portraits of athletes and playing videos that are clipped from game footage.¹²

C. Whether the Gambling Crime Regulation Applies

(a) Basics of NFT (General)

The C-SEP Guidelines demonstrate the view that it is basically reasonable to evaluate the value of NFT in the primary distribution market based on the actual sales price determined by the selling company, etc., for the following reasons.

- The term “gambling” as used in Article 185 and Article 186(1) of the Penal Code refers to cases where persons compete to gain or lose property by fortuitous victory or defeat. In this regard, “compete to gain or lose” means that there must be a two-way relationship of gain or loss where the winner gains property and the loser loses the same. If one party does not lose property, it is not considered that the parties “compete[d] to gain or lose” property.
- NFT are issued independently by each sales company, etc., focusing on their individual characteristics (such as the rights and contents represented by the NFT), and the sales price in the primary distribution market is determined by the sales company, etc., at its own discretion based on the overall supply-demand situation and other factors. Therefore, unlike commodities for which a market price is supposed or stable coins, the value of which is linked to legal tender, it is difficult to find an objective index to calculate the value of NFT other than the price set in the actual act of sale.

¹¹ See https://www.c-sep.jp/2022/09/20/c-sep_nft_guideline/. The C-SEP Guidelines are only a set of rules to be complied with by business operators when providing services similar to NBA Top Shot from the perspective of criminal gambling offenses under the Penal Code and of consumer protection. The business operator needs to separately confirm its compliance with the Financial Instruments and Exchange Law, the Payment Services Act, and other laws and regulations.

¹² It is assumed that the business operators subject to the C-SEP Guidelines have obtained a license from the league or team/club for the use of player portraits, game footage, etc.

(b) Evaluation of NBA Top Shot

The C-SEP Guidelines clarify that the concept of “competing to gain or lose property” is applicable not only for package sales of the variety implemented by NBA Top Shot, but also for random sales in general. The guidelines go on to specify that there is no “competing to gain or lose” property in NBA Top Shot services¹³ and explain as follows in terms of whether those services as offered constitute the crime of gambling.

- Whether NBA Top Shot services constitute gambling comes down to issues between Dapper Labs and its users, and between individual users.
- As between Dapper Labs and its user, Dapper Labs receives money (property) equivalent to the sales price it set, and the user receives an NFT (property) with a value equivalent to the amount paid to Dapper Labs. There is nothing to distinguish this from an ordinary sale and purchase. Since neither Dapper Labs nor the user loses their property, the issue of “competing to gain or lose” property does not arise.
- In terms of relationships between users, if money contributed by one user is transferred to another user, it could be considered that a “competing to gain or lose” property issue has arisen, but no such relationship exists in the NBA Top Shot service. Therefore, no “competing to gain or lose” property issue arises either between Dapper Labs and the user or between the users.

D. Consumer Protection

If NFT package sales and the secondary distribution market are simultaneously provided, it is assumed that the packages may include rare NFTs that may be traded at high prices in the secondary distribution market and, depending on the contents of the service and the transaction prices, etc., in the secondary distribution market, it may overly stimulate the consumers’ desires for gains through chance, leading to damage to such consumers, including minors. In particular, when operators of smartphone games provided systems for converting items, etc., obtained through electronic lotteries to cash, consumers’ desires for gains by chance were stimulated, and the sharp increase in high value charges by minors has become a social issue. Given that situation, the Consumer Commission¹⁴ released its “Opinion on Consumer Issues Concerning Smartphone Games - Viewpoints to Watch” on 20 September 2016.¹⁵ The Opinion outlines the issues that business operators should address from the perspective of consumer protection.

The C-SEP Guidelines point out that, a business operator needs to design a business model that gives enough consideration to the legal interests protected by the gambling regulations and consumer protection, while taking into account the Consumer Commission’s publications and the trends of the Consumer Affairs Agency’s Internet-Based Consumer Transaction Liaison Meeting.

E. Business types that can be legally developed in Japan

The C-SEP Guidelines state that, with certain consumer protection considerations taken into account, services similar to NBA Top Shot with the following business models can be legally deployed in Japan.¹⁶

¹³ An overview of NBA Top Shot services is provided in the C-SEP Guidelines, p.3.

¹⁴ It was established in the Cabinet Office in September 2009 to study and deliberate various consumer issues, and to express its opinions (e.g., make recommendations, etc.) on consumer administration in general by relevant ministries and agencies, including the Consumer Affairs Agency. <https://www.cao.go.jp/consumer/about/>

¹⁵ https://www.cao.go.jp/consumer/iinkaikouhyou/2016/0920_iken.html

¹⁶ Details of the considerations required are described in the C-SEP Guidelines, p.8.

- (1) NFT, such as videos of players playing, are sold to users as packages. The types of NFT are classified according to their rarity, and each package clearly indicates which types of and how many NFT are included. The price of the package varies depending on the types and numbers of NFT included.
- (2) Users can resell NFT that they own on the secondary distribution market operated and managed by the operator and turn them into money. The transaction price can be set freely by users. The operator will charge a certain percentage of the transaction amount of the resale as a commission. Users are not allowed to sell packages on the secondary distribution market.
- (3) The operator does not sell NFT in the secondary distribution market, nor does it buy NFT included in a package from users.

F. Rights related to sharing of revenue from secondary distribution markets

The C-SEP Guidelines provide the following approach to rights related to sharing of revenue from the secondary distribution market.

- In the case of NFT transactions between users in the secondary distribution market, as well as sales of NFT by business operators, such transactions utilize the power of portraits and the like in attracting customers, and therefore, they are considered to have an aspect of utilizing the publicity rights of players (the right to exclusively utilize the power of individual's names, portraits, etc., to attract customers). However, the handling of players' portrait rights and publicity rights are something to be agreed upon in the rules and regulations of each sports league, and compensation for the use of publicity rights does not necessarily have to be directly returned to the players' association of the relevant sports league.
- If a player (a player who has a player contract with his/her team, under which, among others, the team/club controls the publicity rights) retires or transfers to another team after the secondary distribution of an NFT, his/her player contract with his/her team is terminated, and the team to which the player belonged loses the legal basis to receive revenue from the secondary distribution market after the player's retirement or transfer. However, depending on the details of the player's contract, there are cases where the former team may continue to receive revenue even after the player's retirement or transfer.

The C-SEP Guidelines add points to note in addition to stating that operators need to design a business model that appropriately realizes the flow of funds to sports organizations and athletes, taking into consideration the rights related to revenues from the secondary distribution market.

G. Points of Attention in terms of the C-SEP Guidelines

The C-SEP Guidelines compile lawful business types related to services involving NFT package sales utilizing sports content and parallel provision of secondary distribution markets therefor. Business operators should note that (1) the said guidelines are applicable only to NFT utilizing sports content and not to areas such as NFT games. They should also note that, (2) while the guidelines state that, with respect to whether "competing to gain or lose" property (a requirement for the crime of gambling) is found, the same theory as in the C-SEP Guidelines is applicable not only to package sales but also to random sales in general. It should be kept in mind, however, that the guidelines limit such determination on business legitimacy to those involving package sales, since the concept of consumer protection should be considered on a case-by-case basis for each sales type.

In addition, special attention should be paid to the fact that when a seller in the primary distribution market purchases or sells NFT in the secondary distribution market, the risk that their service constitutes a crime increases, and when a separate unit price is set for an NFT included in a package and sold to users in the

primary distribution market (“**selling in bulk**”), careful consideration should be given to determining whether the methods employed constitute gambling and whether the business model is appropriate.¹⁷

2. The Joint Guidelines

(1) Background of Formulation

As stated in 1. above, the C-SEP Guidelines compile supposedly legitimate business types related to services involving NFT package sales utilizing sports content and parallel provision of secondary distribution markets therefor. On the other hands, the Joint Guidelines are more broadly applicable, regardless of whether or not sports content is utilized¹⁸ and not only to package sales; the guidelines are designed to summarize whether “services involving random sales of NFT and parallel provision of secondary distribution market therefor” constitute a crime of gambling (Article 185 and Article 186(1) of the Penal Code) and the business types that are thought to be lawful.

In light of the Consumer Commission's opinion published on 20 September, 2016 for smartphone games, it is necessary to carefully consider whether the services including NFT games in its scope would constitute gambling. As stated in 1. above, however, with respect to the requirement of “competing to gain or lose” property, the same theory as the C-SEP Guidelines is applied not only to package sales but also to overall random sales. For this reason, the Joint Guidelines have been developed with reference to the C-SEP Guidelines and through further deliberate discussions by the attorneys who are members of the Joint Guidelines drafting team, and published on 12 October, 2022¹⁹.

(2) Overview

A. Purpose

The Joint Guidelines were prepared with reference to the framework provided in the C-SEP Guidelines introduced in 1.(2)-E above, for the purposes of sound development of the NFT business, summarizing the types of random sales of NFT that are not considered gambling, and indicating points to be noted by business operators from the consumer protection perspective.

¹⁷ In the case of selling in bulk, there will be multiple unit prices for the single NFT comprising the bulk purchase set by the operator of the primary distribution market. If the unit price of one NFT from such bulk purchase being sold individually deviates from the unit price of the same NFT used as the basis for setting the selling price of a package, that may cause a suspicion that the selling prices of NFT packages are not comparable in value with NFTs that consumers obtain; therefore, it is necessary to carefully determine whether the system a business operator employs could be considered to constitute gambling.

¹⁸ Accordingly, the scope includes NFT games, etc.

¹⁹ Given the fact that the C-SEP Guidelines are the fruit of careful consideration by METI Sports Industry Office, Professor Hashizume and other experts, the Joint Guidelines were prepared by reference to the C-SEP Guidelines, jointly by the Japan Contents Blockchain Initiative (JCBI), Japan Cryptoasset Business Association (JCBA), Japan Blockchain Association (JBA), Blockchain Collaborative Consortium (BCCC) and C-SEP.

B. Scope of Application

As mentioned above, random-type sales include Gacha sales, package sales, reveal sales, random generation sales, and other sales methods, and the Joint Guidelines primarily apply to random-type sales except package sales.²⁰

C. Whether the Gambling Crime Regulation Applies

The Joint Guidelines show the following frameworks with regard to whether random-type sales constitute gambling.

(a) Principles

As a general rule, as in the sale of ordinary goods, it can be said that the selling company obtains money (goods) in an amount equivalent to the actual sales price, and the user obtains NFT (goods) with a value equivalent to the amount actually paid. Therefore, a relationship of mutual gain or loss, where the winner gains the property and the loser loses the property, does not arise. In addition, as for the relationship between users, as in the case of NBA Top Shot, in principle, the transaction is executed only when both parties agree on the price, so there is no mutual gain or loss relationship where the winner gains the property and the loser loses the property, and no “competing to gain or lose” property exists.

However, as described below, in cases (1) where the selling company sets up a secondary distribution market and (2) where a separate sales price is set in the primary distribution market, it may be considered that a “competing to gain or lose” property issue arises between the selling company and the user; in such cases, accordingly, careful consideration is required.

(b) (1) Where the selling company has a secondary distribution market

Even if the selling company has a secondary distribution market for NFT, while the transactions in the primary distribution market are between the seller and the user, the transactions in the secondary distribution market are between users, and the parties to the transactions are different. Therefore, when examining whether a gambling crime exists in terms of the relationship between a sales company and a user, it is not appropriate to consider the secondary distribution market and the primary distribution market as integrated. Moreover, price formation in the secondary distribution market is based on circumstances that are separate from the price setting for the sale of NFT in the primary distribution market, and is not directly related to the price setting by the seller in the primary distribution market. Therefore, the issue of pricing in the primary distribution market should not be confused with that in the secondary distribution market, and even if resale prices are formed in the secondary distribution market established by the selling company, in principle, it is highly unlikely that a “competing to gain or lose” property scenario between the selling company and the user will arise.

However, if the selling company sets the purchase price or resale price and sets a scheme to purchase or resell the NFT in the secondary distribution market itself, there arises room to consider the transaction in the primary distribution market between the seller and the user and the transaction in the secondary distribution market as one and the same. In this case, there is a risk that a “competing to gain or lose” property issue between the parties may be found, and therefore, such scheme should be avoided.

²⁰ Package sales are excluded from consideration in the Joint guidelines because they are already considered in the C-SEP Guidelines described in 1.(2)E above.

(c) (2) Where a separate sales price is set in the primary distribution market

If the selling company sets a separate selling price for NFT that appear in a random sale and sells them to users, and if the selling price of the random sale and the separate selling price diverge, there is a risk that an issue of "competing to gain or lose" property may arise between the seller and the user for the reason that the user does not obtain NFT (goods) of a value equivalent to the amount paid to the seller, or the seller does not obtain money (goods) of a value equivalent to the selling price.

Therefore, when a seller sets a separate selling price, a careful consideration should be given to pricing, e.g., it should either (a) sell all NFT that appear in random sales at the same price regardless of rarity, or (b) if the separate selling prices vary depending on rarity, the selling price in random sales should not exceed the lowest of the separate selling prices.²¹

D. Consumer Protection

Random sales of NFT may result in higher charges until the desired NFT is acquired; also, higher charges may result from speculative purchases. The Joint Guidelines show the view that it is appropriate to pay certain attention lest the random sales of NFT form is used in such a way as to excessively stimulate the consumers' desires for gains by chance, and lest consumers are hindered from making reasonable choices due to inaccurate information about the terms and conditions, etc., of the sales.

In addition, the Joint Guidelines state that, with respect to random sales of NFT to minors, it is desirable, from the perspective of protecting minors, to encourage minors to obtain the consent of a person with parental authority or to set a maximum billing limit by stipulation in the terms of service.

E. Points of Attention in terms of the Joint Guidelines

As described in 2.(1) above, while the C-SEP Guidelines have the limited scope concerning "simultaneous provision of services of package sales of NFT utilizing sports content as well as a secondary distribution market," the Joint guidelines have the widened scope as "simultaneous provision of services of random type sales of NFT and a secondary distribution market" including NFT games.

While the C-SEP Guidelines were developed through deliberate discussions with experts in the working group, the Joint guidelines were developed through discussions mainly by lawyers. Although there are differences in the development process, there would be no difference in the reliability of these two guidelines, given that the Joint guidelines were established by reference to the C-SEP Guidelines.

However, since the scope of the Joint Guidelines is broader than that of the C-SEP Guidelines, it does not completely cover the legality of all types of businesses. Therefore, in comparison, it is assumed that the Joint Guidelines may invite more cases where business operators are at a loss as to whether a service is legal. If the service constitutes gambling, the business could face criminal penalties; therefore, it is necessary for business operators to attentively design individual services even when they are categorized as a legal business under the Joint Guidelines, let alone to correctly check and understand the Joint Guidelines.

3. Conclusion

As mentioned above, with the publication of the C-SEP Guidelines and the Joint Guidelines, it would be fair to say that the possibilities for NFT utilization have further expanded. However, as mentioned in our previous Newsletter, some NFT games with a "loot box" function, which is similar to a "Gacha" sale in Japan, have been

²¹ See footnotes 7 and 8 of the Joint Guidelines for a discussion of specific cases.

evaluated as gambling in Belgium, and in the Netherlands, and a motion calling for loot box regulation has been submitted to the parliament.²²

In light of these global trends and the opinion of the Consumer Commission published on 20 September 2016 targeting smartphone games, etc., it is advisable for business operators to correctly check and understand the scopes of both guidelines, and when considering the launch of a service that deviates even slightly from the relevant scopes, or, even within those scopes, when even the slightest doubt arises regarding the legality of individual services, it is advisable to act deliberately under the advice of lawyers and other experts.

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²² Kaku Hirao, Hironori Inagaki, Kaori Hirose, Yusuke Iwaya, “Recent Topics Related to Sports Business Law” (Nishimura & Asahi Sports Business Law Newsletter, September 6, 2022)