

## Non-Fungible Tokens, Play-to-Earn Scholarships, and Yield Guild Games under Japanese Laws

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In this post, we analyze non-fungible tokens (NFTs), play-to-earn scholarships, and the Yield Guild DAO under Japanese laws. With respect to the scholarships, it is worth noting that they are mainly offered overseas - presumably in compliance with the relevant laws - and that Japanese laws only apply if Japanese residents are involved. The following post is written under the assumption that this is the case.

You can find more information about the legal and regulatory environment for NFTs in our previous posts:

- (1) [‘Play to Earn’ under Japanese Laws](#) (September 2, 2021)
- (2) [NFTs: An overview of the current state in Japan, the legal and regulatory environment, and the latest guidelines by the JCBA and BCA](#) (April 27, 2021)
- (3) [Buyer Beware – Digital Art and Non-Fungible Tokens \(NFT\)](#) (March 22, 2021)

### 1. Overview

#### 1.1. Play-to-Earn (P2E)

The P2E model was pioneered by [Axie Infinity](#). Axie Infinity is an online game that allows players to receive rewards in the form of [Smooth Love Potions \(SLP\)](#) when playing the game. SLP are tokens that are needed for breeding new Axies and which can be traded on global crypto exchanges.

#### 1.2. Scholarships

To play Axie Infinity, a player needs at least three Axies. In August 2021, the price for three Axies was around USD 1,000 and as such unaffordable for many players. Yet, despite the high costs, the game continued to gain popularity - especially in countries with low incomes. One of the reasons behind the continued success were scholarships. Under the scholarship

program, owners of Axies give their Axies to players who in turn use them for playing the game. When earning SLP as rewards, players must share them with the owners of the NFTs. The percentage players retain is somewhere between 40 and 75 percent, depending on the provider of the scholarship and scholarship program.

#### Scholarship programs in a nutshell

- (1) Owners of Axies search for scholars on discord and other platforms.
- (2) Scholars sign scholarship agreements with an owner and start playing the game.
- (3) Rewards earned in the game are shared between the players and the Axies' owners.

Even though scholars may use Axies for playing, they are not authorized to sell them under the scholarship agreement.

### 1.3. Yield Guild Games

[Yield Guild Games \(YGG\)](#) describes itself as a “*play-to-earn gaming guild, bringing players together to earn via blockchain-based economies*”. YGG initially raised funds from a16z and other investors in exchange for YGG tokens and invests those funds into NFTs that are used in blockchain games. Proceeds from utilizing the NFTs - for example from lending the NFTs to players of P2E games or selling them on the market - are distributed to YGG token holders.

In some cases, YGG further brokers scholarships for NFT holders who want to put their NFTs to use and earn a passive income. Initial activities focus on [Axie Infinity](#), [The Sandbox](#), and [League of Kingdoms](#). Further games will be added in the future.

While the core team of YGG currently manages all activities, YGG aims to become fully decentralized in the future. Once the transition is completed, decision-making will be transferred from the core team to the YGG DAO, i.e. the YGG token holders.

## 2. Analysis under the Applicable Laws and Regulations

### 2.1. Legal Structures of Scholarships

Scholars and managers enter into scholarship agreements on an individual basis. Usually, the agreements are initiated via Discord or other channels. Under Japanese laws, the following structures may be considered.

#### 2.1.1. Lease Agreement

Where a scholar promises to pay a certain amount of money for the use of Axies and to return the Axies at the end of the agreement to the manager, the agreement might be considered some form of lease. Since Article 601 Civil Code only covers the lease of tangible assets, it cannot be applied directly to the lease of intangible assets such as Axies.<sup>1</sup> Applying Article 601 ff Civil Code by way of analogy seems, however, possible.

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<sup>1</sup> It is only possible to lease tangible assets within the meaning of Article 85 Civil Code.

Assuming Articles 601 ff Civil Code can be applied analogously, scholars would not be allowed to sublease Axies to third parties without the prior consent of the managers (Article 612(1) Civil Code). In cases where the contract period is not specified by the scholarship agreement, the agreement may be terminated by either party by giving the other party one day's notice (Article 617(1)(iii) Civil Code). As it is not clear whether courts will allow for an analogous application of Articles 601 ff Civil Code, it is advisable to cover all matters comprehensively in the scholarship agreement.

Since the use of Axies is not subject to restrictions under the Copyright Act, it is further advisable to implement proper measures to ensure that owners are sufficiently protected (e.g. prohibition to use Axies for breeding, prohibition to create merchandise with the Axie).<sup>2</sup>

### 2.1.2. Contract for Work or Delegation

Managers may among others specify how many hours a scholar must play per month, require daily logins, or instruct scholars to only use Axies with certain characteristics for breeding. In addition, the scholarship agreement may stipulate a minimum amount of SLP a scholar must earn during a pre-defined period. In exchange, the manager agrees to pay a remuneration to the scholar.

Depending on the exact arrangement, the scholarship agreement may either be considered a contract for work (Article 632 Civil Code) or delegation without legal authority (Article 656 Civil Code). In both cases, scholars would have to deliver earned SLP to the NFT's owner (Articles 632 and 646 Civil Code). Where the scholarship agreement is structured as a contract for work, NFT owners may further require scholars to complete the agreed work (Articles 559 and 562 Civil Code).

It is our understanding that the rewards collected by scholars are generally passed to the manager. Based on the scholarship agreement, the manager will then return a predefined amount to the scholar for playing the game. The situation is, therefore, similar to revenues generated by tenants of farmland.

### 2.1.3. Fund

The scholarship arrangement may further be structured as a partnership according to Article 667 Civil Code or a silent partnership according to Article 535 Commercial Code. In these cases, both the owners of the NFT and the scholar make contributions in kind – the owner by providing his Axies and the scholar by contributing his labor. Profits generated by the partnership or silent partnership are then distributed between NFT owners and scholars according to the scholarship agreement.

In a partnership, the owner may for example invest Axies and appoint the scholar as an executive of the partnership (Article 670(2) Civil Code). Here, the NFT owner would have the right to inspect the scholar's business but lose the right to manage the partnership on his own (Article 673 Civil Code). If the scholar does not play the game and defaults, the agreement cannot be canceled (Article 667-2(2) Civil Code). Instead, the manager may request the dissolution of the partnership (Article 683 Civil Code). A voluntary resignation from the managing position by the scholar appointed as the manager of the partnership would only be

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<sup>2</sup> Articles 21-28 Copyright Act stipulates any acts that cannot be done without the permission of the copyright holder in respect to documents, images, and other copyrighted works.

possible if the scholar has a valid reason for resignation (Article 672(1) Civil Code).

	<b>NFT Owners' Rights and Obligations</b>	<b>Scholars' Rights and Obligations</b>	<b>Other</b>
<b>Lease</b>	<ul style="list-style-type: none"> <li>- receipt of royalties</li> <li>- obligation to provide Axies to the scholar</li> <li>- obligation to replace Axies that do not conform with the characteristics outlined in the scholarship agreement</li> </ul>	<ul style="list-style-type: none"> <li>- obligation to return Axies upon expiration or termination of the scholarship agreement</li> <li>- obligation to manage the Axies with the care of a good manager</li> <li>- prohibition to sublease the Axies</li> <li>- right to demand the reduction of royalties in cases of defect</li> </ul>	If the term is stipulated in the scholarship agreement, the agreement is automatically terminated with its expiration. Otherwise, it can be terminated by either party by giving one day's notice.
<b>Delegation / Contract for Work</b>	<ul style="list-style-type: none"> <li>- obligation to pay remuneration</li> <li>- obligation to provide Axies to the scholar</li> <li>- right to decline or reduce remuneration in case of non-performance by the scholar</li> </ul>	<ul style="list-style-type: none"> <li>- obligation to process certain paperwork and to complete the work</li> <li>- obligation to deliver SLP rewards to the manager</li> <li>- payment for performed services</li> </ul>	The agreement may automatically terminate upon expiration of the term (if specified) or can be canceled by the manager at any time. If the manager decides to cancel the agreement which constitutes a contract for work, he must generally compensate the scholar for losses. If the agreement constitutes a delegation agreement, it may be terminated at any time by either party.
<b>Fund</b>	<ul style="list-style-type: none"> <li>- obligation to invest Axies as an in-kind-investment</li> <li>- right to inspect the status of the business</li> <li>- right to participate in profits</li> <li>- right to demand</li> </ul>	<ul style="list-style-type: none"> <li>- obligation to invest labor as an in-kind-investment</li> <li>- obligation to perform certain services</li> <li>- right to participate in profits</li> <li>- right to demand</li> </ul>	If the partnership has achieved the purpose for which it was set up, it is automatically dissolved. It is also dissolved if there are other reasons for dissolution which are stipulated in the

	dissolution of the partnership	dissolution of the partnership	scholarship agreement. Proceeds are distributed in proportion to each partners' contribution in case of liquidation.
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## 2.2. Regulatory Considerations for the Different Scholarship Structures

The regulatory considerations vary greatly depending on the legal structure of the scholarships. For scholarships structured as leasing arrangements, money lending regulations may be considered. For agreements structured as partnerships or silent partnerships, the Financial Instruments and Exchange Act (**FIEA**) may be applicable. For scholarship structured as delegation agreements or contracts for work, no particular regulations apply.

### 2.2.1. Money Lending Business Act

Article 2(1) Money Lending Business Act defines money lending business as the business of lending money (including the provision of funds by discounted bills, the sale of mortgages, or similar methods) or acting as an intermediary for the lending of money. Businesses engaging in money lending services must register with the Financial Services Agency (**FSA**) (Article 3(1) Money Lending Act).

Since Axies neither constitute money nor a currency-denominated asset, the lending of Axies does not fall under the Money Lending Business Act. It is therefore not necessary to register with the FSA.

### 2.2.2. FIEA

The FIEA applies to a wide range of financial instruments and provides a comprehensive registration regime for businesses engaging in financial instruments services (Article 2(8) FIEA). According to Article 29 FIEA, businesses providing financial instruments services must generally register as a financial instruments business operator (**FIBO**) with the FSA. This also applies to those soliciting the offer to sell rights in a partnership or silent partnership. Both are generally considered collective investment schemes under the FIEA (Article 2(2)(v) FIEA).

Axies do, however, not fall under the category of money or money equivalent as specified in Article 2(2)(v) FIEA, Article 1-3 FIEA Enforcement Order, and Article 5 FIEA Definitions Ordinance. Even where the owner of NFTs contributes his NFTs to the partnership or the silent partnership, the FIEA does therefore not apply.

## 2.3. Regulatory Considerations concerning YGG's Activities

### 2.3.1. Scholarship Brokerage

Since NFTs do not constitute money or currency-denominated assets (see item 2.2.1 above), the brokerage of scholarships does not constitute an intermediary service for money lending and is therefore not regulated.

### 2.3.2. YGG Tokens

On August 19, 2021, [YGG announced that it had raised USD 4.6 million from a16z and](#)

[other major venture capital firms](#). In exchange for their investment a16z and the other investors received YGG tokens. The tokens allow them to participate in the revenues generated by the YGG. Assuming the tokens were sold to investors in Japan, it is highly likely that they would qualify as rights in a collective investment scheme under Article 2(2)(v) FIEA – and given the tokenization of those rights – as electronically recorded transfer rights (Article 2(3) FIEA). In order to offer electronically recorded transfer rights to the public, it is generally necessary to file a prospectus and to register as a type II FIBO (Articles 28(2)(i), 2(8)(vii), 29 FIEA). Where the rights are only offered to qualified institutional investors a notification under Article 63 FIEA is sufficient.

If the solicitation is, however, performed by a DAO with a sufficient degree of decentralization, the solicitation falls outside the scope of the FIEA as there is no eligible intermediary that could be regulated. As YGG is still managed by the core team, this degree of decentralization has most likely not been achieved yet.

Finally, it should be noted that collective investing schemes investing in NFTs are not subject to disclosure obligations under Article 4 FIEA, as NFTs do not constitute securities.

### 2.3.3. Investment in NFTs

A fund investing exclusively in NFTs does not invest “*in securities or in rights connected with derivatives transactions, based on investment decisions that are grounded in an analysis of values of financial instruments*” as stipulated in Article 2(8)(xii) FIEA. It is therefore unlikely that the investment management regulations apply to the investment manager (Article 28(4)(i) FIEA).

As NFTs are further not considered crypto assets within the meaning of Article 2(7) Payment Services Act, the buying and selling of NFTs for investment purposes does not constitute a crypto asset exchange business. It is therefore not necessary to register as a crypto asset exchange service provider.

## **Disclaimer**

This post is for discussion only. The content of this post has not been confirmed by the relevant authorities or organizations mentioned in the post but merely reflects a reasonable interpretation of their statements. The interpretation of the laws and regulations reflects our current understanding and may therefore change in the future.

This post does not recommend the use of or investment in NFTs, scholarships, or any other tokens or projects.

Axie Infinity and Yield Guild Games are only used for illustrative purposes. Given the format of the post, not all details of the game mechanics and token design have been considered comprehensively, so that the results of the assessment may deviate from the results by the regulator, or a legal opinion prepared by us or another law firm. By no means, the explanations should be understood as a legal opinion. If you need legal advice on a similar project, please free to contact us or consult with your lawyer.