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Acquiring Mobile Gaming Enterprises: Seven Essential Legal Due Diligence Checkpoints

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Summary

This article offers an examination of key legal considerations that come into play during mergers and acquisitions in the Japanese e-gaming industry, with a particular focus on the due diligence process. Areas explored encompass disclosure requirements to game users, information security measures, mandatory governmental filings, management of unused in-game currency balances, and overarching regulatory compliance. Given the rapidly evolving landscape of the e-gaming industry, it is crucial to perform meticulous due diligence to ensure that the M&A transaction aligns with existing legal frameworks as described below.

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Introduction

In recent years, the expansion of the gaming market, driven in part by the COVID-19 pandemic, has led companies to adopt various measures to secure a competitive edge. These efforts are further complicated by the relatively short product life cycles typical of video games and the increasing diversity of gaming platforms. One of the most noteworthy strategies emerging in this context is the focus on mergers and acquisitions.

Globally, a vivid example is Microsoft's recent acquisition of Activision Blizzard.¹ In Japan-related transactions as well, noteworthy events are unfolding. For instance, Sony Interactive Entertainment (SIE) made headlines in 2022 when it acquired the American video game company Bungie for \$3.6 billion.² SIE also announced its acquisition of Firesprite, a development studio based in Liverpool, United Kingdom.³ Further, in April 2023, SEGA Sammy Holdings Inc. announced its acquisition of Finland's Rovio Entertainment Oyj, the company behind popular games such as Angry Birds, for 700 million euros.⁴ These moves appear to underscore the increasing importance of geographical diversification in the gaming industry, as well as the acquirers' strategy to enriching its game development capabilities and broadening its intellectual property portfolio.

While the three examples cited above involve Japanese corporations acquiring overseas companies, future trends in the gaming industry are likely to be more diverse. Given the sector's characteristics and recent M&A activity, it is reasonable to expect scenarios where foreign corporations seek to acquire Japanese gaming companies. Alternatively, in M&A transactions between non-Japanese corporations, the target company or its affiliates might be engaged in publishing games in Japan.

In light of these complexities, this column aims to elucidate key issues that typically arise in due

¹ "Microsoft to acquire Activision Blizzard to bring the joy and community of gaming to everyone, across every device"

<https://news.microsoft.com/2022/01/18/microsoft-to-acquire-activision-blizzard-to-bring-the-joy-and-community-of-gaming-to-everyone-across-every-device/>

² "Sony Interactive Entertainment to acquire leading independent videogame developer, Bungie."

https://www.sony.com/content/sony/en/en_us/SCA/company-news/press-releases/sony-interactive-entertainment/2022/sony-interactive-entertainment-to-acquire-leading-independent-videogame-developer-bungie.html

³ "Sony Interactive Entertainment to Acquire Firesprite"

<https://sonyinteractive.com/en/press-releases/2021/sony-interactive-entertainment-to-acquire-firesprite/>

⁴ "SEGA to Acquire Rovio Entertainment Oyj"

<https://www.segasammy.co.jp/en/release/34194/>

diligence when the target company or its associated entities are publishing mobile games in Japan. Additionally, we will explore how to address these concerns within the framework of M&A contracts, particularly when legal compliance gaps are discovered during the due diligence process.

It is important to note that this column provides a general overview of typical regulatory issues that arise when the target company or its affiliates are distributing games in Japan. This is not intended as legal advice for any specific transaction. The points raised here are by no means exhaustive; comprehensive due diligence will invariably require consideration from various legal perspectives including corporate, contracts, intellectual property, labor and employment, competition law, and more. Moreover, the issues at stake can vary depending on the specific nature of the target company's business and the particularities of the deal. Additionally, it should be noted that gaming-related laws and regulations are subject to frequent amendments. As such, parties involved in an actual deal must obtain the most up-to-date legal advice for their due diligence.

I. TELECOMMUNICATIONS BUSINESS ACT

Checkpoint 1: Communication Functions

Does the target's game allow players to communicate with each other in the game?

Key Points

If the target company's game allows players to communicate with each other, compliance with the Telecommunications Business Act is essential. The operator is obligated to submit a Notification to the Ministry of Internal Affairs and Communications (MIC). If one violates this obligation, the penalties could be imprisonment for up to three years or a fine of up to 2 million yen.

Required Documents and Timeline for MIC Filing by Foreign Corporations

Typically, the following documents must be submitted:

- 1) Telecommunication Business Notification Form
- 2) Certificate of Authority
- 3) Proof of Identity for Authorized Domestic Representative
- 4) Network Configuration Diagram
- 5) Description of Telecommunication Services Provided
- 6) Document equivalent to Articles of Incorporation
- 7) Japanese translation of the preceding document (Point 6)
- 8) Document certifying registration details in the home country of the foreign corporation

9) Japanese translation of the preceding document (Point 8)

The MIC often requests additional documents or clarifications, particularly from foreign entities, potentially extending the filing process by several weeks to 2-3 months.

Due Diligence and Contractual Provisions

In the due diligence process, the buyer should determine whether the target company has fulfilled its filing requirements under the Telecommunications Business Act. This is critical given that modern mobile games often include chat functions, making them subject to this Act.

If non-compliance is discovered, it may not be realistic to expect the seller to complete the filing before closing due to the potentially extended time frame, depending on the timeline of the deal. In such cases, the buyer may need to undertake this responsibility post-closing. The seller could be obliged to cooperate as needed.

II. SPECIFIED COMMERCIAL TRANSACTIONS ACT

Checkpoint 2: Information Provision to Game Users

Does the target company provide the following information to the game users?

- 1) Compensation for services***
- 2) Timing and method of payment for the compensation***
- 3) Timing of service provision***
- 4) Content of clauses pertaining to the duration of the application, if applicable***
- 5) Details of the clauses on withdrawal or cancellation of the application for the subject contract.***

Key Compliance Points

If transactions involving the purchase of coins or items in the game occur, these are subject to regulation under the Specified Commercial Transactions Act. Additionally, when there is advertising about these coins or items, the above-mentioned information must be provided to game users. When drafting the content to be displayed, adherence to both the Specified Commercial Transactions Act and its corresponding Enforcement Order is required. If one breaches this obligation, the penalties include directives for business improvement, business suspension orders, and business prohibition orders from the government.

The aim of these regulations is to prevent future disputes over transaction terms by requiring sellers

or service providers to clearly display certain matters in their advertising, which often serves as the sole source of information for buyers.

To provide this information, a dedicated page outlining these details should be set up within the game's official website. A link to this page should be accessible within the game, enabling users to access the information easily.

Due Diligence Considerations

If, during due diligence, it is found that the target company has not complied with the Specified Commercial Transactions Act, the typical response from the buyer is to demand immediate compliance. As the information required under this Act is generally straightforward and not overly complicated, it would not typically take a long time to comply—usually, it can be completed within a span of one to two weeks, or at most, a few weeks.

Therefore, it is often not problematic for the parties to include a provision in the definitive agreement obligating the seller to complete the information provision requirements per the Act before closing the transaction. Alternatively, if non-compliance is discovered during due diligence, the seller may promptly fulfill this obligation to remedy the deficiency, even before the definitive agreements are finalized.

Checkpoint 3: Advertisement to Game Users

Does the target company send advertisements to email addresses of game users? If yes, has the target company obtained prior consents from game users?

Legal Ramifications

Should the target company engage in email advertising directed at game users, the law mandates that prior consent from these users be obtained. The absence of such consent makes the operation illegal.

While the majority of gaming companies are likely to comply with this requirement, any violation, especially if it severely hampers fair trade and infringes upon consumer interests, could result in a penalty of up to one year of imprisonment or a fine not exceeding two million yen. Additionally, the authority may issue operational directives or cease-and-desist orders.

Due Diligence and Contractual Provisions

Given the above legal ramifications, one of the objectives should be to ascertain whether the target

company has sought and obtained prior consent from game users for email advertising. In the definitive agreements, it would be prudent to include a representation and warranty clause where the seller confirms compliance with these regulations.

III. ACT AGAINST UNJUSTIFIABLE PREMIUMS AND MISLEADING REPRESENTATIONS

Checkpoint 4: Prize to Game Users

Does the target's game offer prizes with economic value to game users?

Key Points

The Act Against Unjustifiable Premiums And Misleading Representations (the Premiums Act) regulates the representation regarding the quality of goods and services, as well as excessive gifting. Games that offer prizes with economic value could fall under its scope. For ordinary mobile games not involving NFT games,⁵ violations are generally considered uncommon among gaming companies, but due diligence is crucial to confirm compliance.

Due Diligence and Contractual Provisions

In the due diligence process, the buyer should determine whether the target company is offering prizes within the game that have an economic value. To the extent that the subject games are not NFT games, it is often sufficient to conduct a cursory review for this particular issue, but due diligence should still confirm that the practice is not being conducted. In the definitive agreements, one could consider having the seller represent that no prizes with economic value are offered in the game. However, given that violations are typically rare, it might be more practical to have a broader representation. Specifically, the seller could represent that there are no violations of local relevant laws, including the Premiums Act.

IV. PAYMENT SERVICES ACT

Checkpoint 5: Unused Balance and Regulatory Compliance

Does the unused balance of in-game currency (prepaid services instruments) exceed 10 million yen?

If yes:

- 1) Does the target company have a subsidiary or a branch in Japan?***
- 2) Has the target company filed a notification with the Financial Services Agency (FSA)?***

⁵ When publishing NFT games, gaming companies must be vigilant of various legal regulations concerning NFTs, such as the Payment Services Act, gambling-related regulations, and the Premiums Act. We will discuss legal considerations regarding NFT games in a separate column.

- 3) *Has the target company placed a security deposit to the Legal Affairs Bureau?*
- 4) *Does the target company regularly report the amount of the unused balance to the FSA at the end of every March and September?*

Checkpoint 6: Information Disclosure to Users

Does the target company provide the following information to the users of the game?

- 1) *The scope of premises or places where in-game currency may be used.*
- 2) *Important points to consider when using in-game currency.*
- 3) *Information about unused balances, or the method for users to determine their unused balances.*
- 4) *The existence of terms and conditions or instructions for the use of in-game currency.*

Checkpoint 7: Information Security Measures

Does the target have measures to prevent the leakage or loss of information about the issuance of in-game currency in place?

Key Compliance Points

Under the Payment Services Act, if the unused balance exceeds 10 million yen, a foreign company must establish either a branch or a subsidiary in Japan. This Japan-based entity is required to file a “Notification of Issuance of Prepaid Payment Instruments” with the FSA.

The Notification to the FSA requires extensive details about the game publisher and the prepaid payment instruments it issues, including types, names, unit prices, and other specific information. Further, screenshots of the in-game currency and information about the terms of use for each game and any contracted companies for issuance of the prepaid payment instruments must also be included in the Notification. This can be a cumbersome and time-consuming process for companies that issue multiple games and various types of in-game currencies.

If the unused balance exceeds 10 million yen, a security deposit equal to half of the unused balance must be placed with the Legal Affairs Bureau, usually before filing the notification.

Handling Non-Compliance with the Payment Services Act Discovered During Due Diligence

A. Preliminary Measures

1. **Information Disclosure to Users (Checkpoint 6):** Drafting and providing the requisite information is generally straightforward and could typically be completed within 2-3 weeks.

2. **Data Security (Checkpoint 7):** Most sophisticated gaming companies will already have measures in place to prevent information leakage. Thus, it is unlikely that addressing this alone will be overly time-consuming.

B. Time-Intensive Measures

1. Establishing a Japan-based Entity (Checkpoint 5)

Foreign game companies subject to the Payment Services Act must first establish either a branch or subsidiary in Japan, a procedure that can take from 1-2 months to several months.

2. Security Deposit (Checkpoint 5)

If the obligation to place a security deposit has been neglected for an extended period and there is a substantial unused balance of in-game currency, the required deposit amount can be substantial, sometimes amounting to several million USD. Preparing such a large sum may necessitate extended internal procedures and time, affecting the pace of regulatory compliance. Accordingly, for foreign corporations, this can take 1-2 months.⁶

The deposit can be made directly from an overseas parent company to the Legal Affairs Bureau's bank account. Therefore, the company is not required to have a bank account in Japan at the time of placing the deposit. Of note, should the game company cease its operations in Japan and wish to reclaim the security deposit, it is imperative that the company have a domestic Japanese bank account.

3. Notification to FSA (Checkpoint 5):

Compliance review, drafting, and submission can potentially be completed in a couple of months, although it might take several months if complications arise. Specifically, the FSA is fastidious in its review and oftentimes require corrections, additional information, or clarification on the details submitted in the notification. Further, if there has been a prolonged period of non-compliance by the company, the FSA may require the submission of a "Supplemental Explanation for the Delay of Reporting," adding another layer to the compliance process and may extend the timeframe.

Given these complexities and potential delays, immediate rectification before closing an M&A deal might be unrealistic. A strategic approach would be to expressly stipulate this deviation in

⁶ One can negate the need to place a security deposit by either (i) entering into an issuance protection (guarantee) agreement with a financial institution, or (ii) signing an issuance trust agreement with a trust company. However, the process of drafting and finalizing such agreements can also span a couple of months.

the representation and warranties section of the definitive agreements. The buyer could undertake to fulfill these obligations post-closing, with the seller agreeing to cooperate to a reasonable extent. Due to the time and costs involved in the rectification process, parties may agree to adjust the acquisition price to reflect these factors, in addition to the amount of the security deposit.

Thus, both parties should aim for a balanced approach, taking into account the complexities of compliance with the Payment Services Act in Japan, particularly concerning unfulfilled obligations related to security deposits and notifications to the FSA.

For further details on compliance requirements under the Payment Services Act, you may refer to our previously published column: “Call of Legal Duty: Navigating the Payment Services Act for In-game Currency in Japan,” available at the following link:

<https://esports.mps-legal.com/column/203>

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