
APPLICABLE LAWS AND REGULATIONS

This section summarises the most significant aspects of the Japan laws and regulations that are material to our business.

A. GENERAL OVERVIEW OF THE JAPAN LEGAL SYSTEM

1. Primary Features

The Japanese legal system has the following key features:

- **Hybrid civil law system.** The Japan legal system is a hybrid civil law system with characteristics of both: (1) civil law systems, such as the French and German civil legal systems; and (2) common law systems, such as the Hong Kong and United States legal systems.
- **Criminal prosecution.** Any act, including our operations under the Three Party System, shall not be subject to criminal prosecution unless such act is explicitly and clearly described as a crime under a strict contextual interpretation of the applicable statutory provisions.
- **Court rulings.** Although court rulings have a *de facto* binding effect on inferior courts, they do not modify existing law nor do they create new law. Laws can only be adopted or modified through the legislative process. Further, court rulings, similar to court rulings in other civil and common law systems elsewhere, may be overturned by laws and regulations and/or amendments to existing laws and regulations enacted or adopted by legislative or executive authorities.
- **Supreme Court (最高裁判所).** The highest court is the Supreme Court (最高裁判所).

2. Historical Background

The early modernisation of the Japan legal system in the mid-19th century to the early-20th century was primarily influenced by the German and French codes, which are civil law codes that served as models for the major Japanese codes such as the Civil Code.

After the Second World War, some laws in Japan such as the Constitution of Japan (日本国憲法), criminal procedure laws and labour laws were amended or replaced using principles from United States law, which is based on the common law. Therefore, the Japan legal system is a hybrid of the civil law system and the common law system, and has evolved substantially and independently in accordance with the Japan legal culture.

The distinction between common law and civil law mainly lies in the precedential value of case law. In a common law legal system, judicial decisions of superior courts have precedential value in later court decisions and form part of the common law, along with laws and regulations enacted or adopted by the legislative and executive branches of government. As a result, judges in a common law system have a substantial role in shaping the law.

APPLICABLE LAWS AND REGULATIONS

In contrast, a civil law system tends to be a codified body of broad and general principles. The judge's role is to establish the facts of the case and to apply the provisions of the applicable code. Judicial decisions are consequently less crucial in the development of the law.

3. Constitution

Japan's current legal system was established by the Constitution of Japan (日本国憲法), promulgated on 3 November 1946 after the Second World War. The Constitution of Japan (日本国憲法) provides for the separation of the legislative, judicial and executive powers.

The Constitution of Japan (日本国憲法) establishes a parliamentary system of government, where the legislative authority is vested in the Diet. The executive authority is exercised by the Prime Minister and the Cabinet of Japan* (内閣) who are answerable to the legislature; and the judiciary is headed by the Supreme Court (最高裁判所).

4. Source of Law and Legislative Process

The sources of Japan law include the Constitution of Japan (日本国憲法), treaties and international agreements, acts, cabinet orders, ministerial ordinances and ministerial notifications.

Under Article 98 of the Constitution of Japan (日本国憲法), the Constitution of Japan (日本国憲法) is the supreme law of the nation and no law, ordinance, imperial rescript or other act of government, or part thereof, contrary to the provisions hereof, shall have legal force or validity.

Under Article 41 of the Constitution of Japan (日本国憲法), the Diet is the highest organ of state power and the sole law-making body. The Diet is made up of two houses, namely the House of Representatives (衆議院) and the House of Councillors (参議院). Under the Japanese legislative process, most draft bills come from the bureaucrat and are then submitted to the Diet through the Cabinet of Japan* (内閣). To become law, a bill must pass both houses of the Diet. Japan law comprises written laws that fit into a certain hierarchy, headed by the Constitution of Japan (日本国憲法). Statutes are often sorted by subject matter into substantive and procedural laws. The Cabinet of Japan* (内閣) and each Ministry may make subordinate regulations such as Cabinet Orders, Ministry Ordinances and Ministry Notifications based upon delegation from the Diet.

5. Judiciary

Under the Constitution of Japan (日本国憲法), the Supreme Court (最高裁判所) is the highest court in the nation exercising appellate jurisdiction. The high courts are appellate courts primarily hearing appeals from district courts or family courts. The district courts are primarily courts of general and first-instance jurisdiction handling all cases. The summary courts have original jurisdiction over civil cases involving claims not exceeding ¥900,000 and minor criminal offences.

APPLICABLE LAWS AND REGULATIONS

The Supreme Court (最高裁判所) is only able to overturn its own interpretation of a law through the full Supreme Court (最高裁判所). If a lower court's judgment does not follow the judgment rendered by the Supreme Court (最高裁判所), the decision may be appealed. Therefore, although Japan does not strictly speaking adopt the common law system (as is the case in Hong Kong) the Supreme Court's (最高裁判所) judgments have a *de facto* binding effect on any court in subsequent cases.

6. Choice of Law (Act on General Rules for Application of Law) (法の適用に関する通則法) of Japan (Act No. 78 of 2006)

The rules for choice of law, which will be taken by Japanese courts as international private law, is mainly governed by the Act on General Rules for Application of Laws. (法の適用に関する通則法) of Japan (Act No. 78 of 2006)

The formation and effect of a juridical act, including without limitation contracts, shall be governed by the law of the place chosen by the parties. In the absence of such choice, the formation and effect of a juridical act shall be governed by the law of the place with which the act is most closely connected at the time of the act. In such case, if only one of the parties to a contract is to provide performance involved in a juridical act, the law of the habitual residence of the party providing such performance shall be presumed to be the law of the place with which the act is most closely connected. In cases where the party has a place of business connected with the juridical act, this will be the law of the place of business. In cases where the party has two or more such places of business which are connected with the juridical act and which are governed by different laws, this will be the law of the principal place of business. The parties may change the governing law otherwise applicable to the formation and effect of a juridical act; provided, however, that if such change prejudices the rights of a third party, it may not be asserted against the third party.

7. Penal Code and the Code of Criminal Procedures (刑事訴訟法) of Japan (Act No. 131 of 1948)

Crimes in Japan are mainly enumerated in the Penal Code, which provides the elements of different types of crimes and the penalties for different types of crimes. The Penal Code sets out the minimum and maximum sentences for offences. Penalties range from fines and short-term incarceration to compulsory labour and the death penalty.

Under Article 31 of the Constitution of Japan (日本国憲法), the requirements for constituting a crime under the Penal Code and any other criminal laws shall be construed strictly in accordance with the specific provisions contained in these laws. Any interpretations that rely upon analogy to other laws, or that look to similar treatment for actions under other laws, are prohibited. Therefore, under Japan law, an act shall not be punishable unless such act is explicitly and clearly described as a crime under a strict contextual interpretation of the corresponding provisions.

APPLICABLE LAWS AND REGULATIONS

A person shall not be subject to any criminal liability without procedural due process being observed under the Code of Criminal Procedures (刑事訴訟法) of Japan (Act No. 131 of 1948). Police have to secure warrants to search for or seize evidence. A warrant is also necessary for an arrest, although if the crime is very serious or if the perpetrator is likely to flee, it can be obtained immediately after arrest. Within forty-eight hours after placing a suspect under detention, the police have to present their case before a prosecutor, who is then required to apprise the accused of the charges and of the right to counsel. Prosecution will be denied if there is insufficient evidence or on the prosecutor's judgment. Most offences are tried first in district courts before one or three judges, depending on the severity of the case. Defendants are protected from self-incrimination, forced confession, and unrestricted admission of hearsay evidence. In addition, defendants have the right to counsel, public trial, and cross-examination.

8. Civil Code

a. Structure of Civil Code

The Civil Code was enacted in 1896. It was heavily influenced by the German Civil Code and the French Civil Code. The code is divided into five parts, namely General Provisions, Property, Claims, Family and Inheritance. The parts related to family and succession retain certain elements of the old patriarchal family system that was part of Japanese tradition. The Civil Code has remained substantially unchanged even after the American occupation in 1945, except for the fourth and fifth parts.

b. Contract Law

As is the case for many countries, contracts under Japan law are formed by the manifestation of intention by way of offer and acceptance. The parties generally enjoy freedom to agree on the terms and conditions of any contract which will supersede most provisions of the Civil Code. However, some contracts may be subject to the mandatory requirements under the Consumer Contract Act (消費者契約法) of Japan (Act No. 61 of 2000) and other applicable laws and regulations. The formation of contracts does not require documentation unless otherwise required under special laws and regulations. Contrary to common law jurisdictions, consideration is not necessary for a contract to be enforceable. Also, there are no rules directly equivalent to the parol evidence rule in interpreting the terms and conditions of the contract.

c. Torts

Under the Civil Code, a person who has intentionally or negligently infringed on any right of another, or a legally protected interest of another, shall be liable to compensate the other party for consequential damages. An employer is liable for damages inflicted on a third party by the actions of his/her employees in the execution of the employer's business. However, this shall not apply if the employer exercised reasonable care in appointing the employee or in supervising the employee's activities, or if the damages could not have been avoided even if he/she had

APPLICABLE LAWS AND REGULATIONS

exercised reasonable care. If more than one person has inflicted damages on another party or parties by their joint tortious acts, each of them shall be jointly and severally liable to compensate the other party or parties for those damages. The same shall apply if it cannot be ascertained which of the joint tortfeasors inflicted the damages.

d. Property

Property rights are based upon the concept of ownership (title) under Japan law. The owner of the property generally enjoys an absolute right to possess, utilise and dispose of the property, unless otherwise restricted under the mandatorily applicable laws or specifically agreed through a contract. Therefore, there is no concept of negative or affirmative covenants under Japan law and the same purpose is achieved by mandatory laws in Japan (such as zoning or building or environmental laws and regulations) or by specific contractual arrangements.

Under the Civil Code, no type of property can be established other than those prescribed by laws including the Civil Code. The creation and transfer of property rights shall take effect solely by the manifestations of intention of the relevant parties. Any deed or written agreement is generally not required for the transfer of property (including land ownership) to be valid and enforceable under Japan law and oral agreement is generally sufficient. However, the acquisition or loss of or any change in property rights concerning immovable property may not be asserted against a third party unless the same are registered pursuant to the applicable provisions of the Real Estate Registration Act* (不動産登記法) (Act No. 123 of 2004) and other applicable laws and regulations regarding land registration.

B. REGULATORY FRAMEWORK FOR PACHINKO BUSINESSES

Our pachinko and pachislot hall operations are subject to various requirements and restrictions under Japan law and oversight by Japanese regulatory authorities. Generally, pachinko regulations fall under the Amusement Business Law and the Cabinet of Japan* (内閣) and ministerial ordinances and regulations thereunder. In particular, the Penal Code states that “gambling” is an offence, while the Amusement Business Law (and its ancillary prefectural local regulations) prohibits pachinko hall operators from being involved in the exchange of prizes for cash or securities by either providing cash or securities as prizes or repurchasing from customers the prizes provided to them. In order to ensure compliance with the Penal Code and the Amusement Business Law, the pachinko industry operates under the “Three Party System” as described in greater detail in “— C. Legality of Pachinko Businesses and the Three Party System” and also in “Business — Pachinko and Pachislot Hall Operations — Three Party System”.

We are also subject to Japan laws and regulations that require pachinko hall operators to obtain operating licenses and impose various operating requirements on pachinko halls and pachinko and pachislot machines, as well as other Japan law and regulations applicable to Japanese companies generally, such as those relating to corporate governance, taxation and labour.

APPLICABLE LAWS AND REGULATIONS

Pachinko is a well-established business and has been in place in Japan for more than eight decades. The history of the pachinko industry has been characterised by government efforts to reform the industry to curb speculative excesses and perceived social problems relating to the industry. Prior to the later part of the period from 1995 to 1999, questionable business practices and crime and other anti-social forces gave the pachinko industry a negative public image. However, over the last two decades, the growing magnitude and importance of pachinko to the Japanese economy spurred the Japanese government and industry associations to step in to establish strict regulations, remove criminal and anti-social elements and improve the public image of the pachinko industry. The regulation effort has been highly successful. Due to the success of these reform efforts, the pachinko industry has evolved to become an integral part of the entertainment industry in Japan and an important component of the Japanese economy.

The table below sets out the major regulatory developments that have affected the pachinko industry and the Three Party System over time:

Date	Events
17 July 1880	The predecessor to the current Penal Code is first enacted, including provisions equivalent to the present provisions related to “gambling” and “running a gambling place for the purpose of gain” (Articles 260 and 261), which provided that: (1) “gambling” is a criminal offence punishable by imprisonment for one to six months and/or a fine of ¥5 to ¥50; and (2) “running a gambling place for the purpose of gain” is a criminal offence punishable by imprisonment for 3 months to one year and/or a fine of ¥10 to ¥100.
24 April 1907	The Penal Code is promulgated, replacing its predecessor. The Penal Code includes provisions equivalent to the present provisions related to “gambling”, “habitual gambling” and “running a gambling place for the purpose of gain” (Articles 185 and 186), which provided that: (1) “gambling” is a criminal offence punishable by a maximum fine of ¥1,000; (2) “habitual gambling” is a criminal offence punishable by up to three years’ imprisonment; and (3) “running a gambling place for the purpose of gain” is a criminal offence punishable by imprisonment of three months to five years.
1930	The first pachinko hall in Japan is opened in Nagoya (名古屋市), Aichi Prefecture (愛知県), Japan.
1942 to 1945	The pachinko hall business is temporarily banned during World War II as an unnecessary business in times of emergency.

APPLICABLE LAWS AND REGULATIONS

Date	Events
10 July 1948.	<p>The “Act Regulating Amusement Business” (風俗営業取締法) is enacted, under which pachinko hall operations became subject to licensing by the Public Safety Commission. Under Article 3 of this Act, each prefecture may set restrictions on amusement business operators, necessary to prevent harm to good morals.</p> <p>Therefore, most prefectures began promulgating local regulations prohibiting pachinko halls from:</p> <ol style="list-style-type: none">1. providing cash as prizes;2. repurchasing from customers the prizes provided to them by those pachinko halls (the “Direct Repurchase Regulation”); and3. causing a third party to repurchase the prizes (the “Indirect Repurchase Regulation”).
10 November 1953.	<p>The Supreme Court (最高裁判所) (the highest court of Japan) stated in their judgment that, if an operator of a gaming licence operates its gaming business in accordance with the conditions and restrictions applicable to its operating licence duly granted by the Public Safety Commission under the “Act Regulating Amusement Business” (風俗営業取締法), such business activities can be deemed as an “activity involving betting for a thing that is provided for temporary amusement” under Article 185 of the Penal Code, thus, shall not be constitute any “gambling” offence under the Penal Code.</p>
1961	<p>An early form of the Three Party System is adopted in the Osaka Prefecture (大阪府). Since then, the Three Party System has spread across Japan</p>
17 June 1968.	<p>The Fukuoka High Court (福岡高等裁判所) holds that there is no violation of the Direct Repurchase Regulation or Indirect Repurchase Regulation in local regulations, if prizes are commingled with prizes from other sources, because it will be impossible to identify which of the prizes being purchased by the pachinko hall were originally from that same pachinko hall.</p>

APPLICABLE LAWS AND REGULATIONS

Date	Events
14 August 1984	The “Act Regulating Amusement Business” (風俗営業取締法) is renamed the “Act on Control and Improvement of Amusement Business, Etc.” (風俗営業等の規制及び業務の適正化等に関する法律) (i.e. the Amusement Business Law), introducing the Direct Repurchase Regulation (previously only in local regulations) into national legislation, and is substantially amended to prohibit, among others, under Article 23: <ol style="list-style-type: none">1. providing customers with cash or securities as prizes; and2. repurchasing from customers the prizes provided to them.
August 1984	Most prefectural government has passed local regulations ancillary to the Amusement Business Law, which included the Indirect Repurchase Regulation as well as the Direct Repurchase Regulation.
11 January 1985	The Enforcement Ordinance is enacted, setting the maximum limit on the value of a prize offered by an amusement business to ¥3,000.
25 September 1990	The Enforcement Ordinance is amended, raising the maximum limit on the value of a prize offered by an amusement business to ¥10,000 (after consumption tax) (approximately ¥9,524 before consumption tax) (Article 35, Paragraph 3).
17 April 1991	The Penal Code is amended to raise the maximum penalty for the criminal offence of “gambling” to a fine of ¥500,000 (Article 185).
25 June 2003	The National Police Agency answers questions raised by the “Group of Diet Members Considering Casino as an International Tourism Industry” (国際観光産業としてのカジノを考える議員連盟) and comments in support of the Three Party System in terms of both the Penal Code and the Amusement Business Law. The comments state that (among others): (1) pachinko halls that operate their business within the scope provided under the Amusement Business Law shall not be considered to have committed any “gambling” offence under the Penal Code; and (2) since the Amusement Business Law only regulates pachinko hall operators (and not persons or entities unrelated to the pachinko hall operator), third parties are not prohibited from purchasing prizes from pachinko hall customers.
1 April 2014	The Enforcement Ordinance is amended, raising the maximum limit on the value of a prize offered by an amusement business to ¥10,368 (after consumption tax) (¥9,600 before consumption tax).

APPLICABLE LAWS AND REGULATIONS

Principal Administrative and Regulatory Authorities

The following are the principal administrative and regulatory authorities that oversee pachinko and pachislot hall operations in Japan:

- the National Public Safety Commission (including the National Police Agency);
- the Prefectural Public Safety Commission in the prefecture in which the relevant hall is located;
- police personnel;
- prefectural governments;
- the Security Communications Association* (保安通信協会);
- the Prefectural Entertainment Environment Cleanup Association* (都道府県風俗環境浄化協会); and
- the Minors Orientation Committee* (青少年健全育成審議会).

National Public Safety Commission (including the National Police Agency)

The National Public Safety Commission is an administrative commission belonging to the Cabinet Office* (内閣府) in the Cabinet of Japan* (内閣). It oversees national security in Japan and implements regulations relating to the technical specifications of pachinko and pachislot machines as well as the operations of pachinko halls. For example, the National Public Safety Commission regulations in conjunction with the Amusement Business Law govern the playing costs of pachinko games, machine designs, maximum payout ratios, maximum balls and pachislot tokens put into play and won, method of providing prizes, maximum value of prizes offered and the minimum age for playing pachinko.

The National Public Safety Commission also oversees the National Police Agency, which leads the prefectural police in their implementation of National Public Safety Commission regulations and policies.

Prefectural Public Safety Commission

Each prefecture has its Prefectural Public Safety Commission, which is an administrative commission that supervises prefectural police agencies in their implementation of the National Public Safety Commission policies and regulations. Each Prefectural Public Safety Commission has the power to grant or cancel pachinko hall licences, grant permission for changes in the structure of pachinko halls, certify and approve pachinko and pachislot machines, approve the technical standards for pachinko and pachislot machines and monitor violations of laws and

APPLICABLE LAWS AND REGULATIONS

regulations by pachinko hall operators. It has the authority, to the extent necessary for enforcement of the Amusement Business Law, to require holders of a pachinko hall licence to submit documentation concerning business matters. It also conducts hearings related to revocation, suspension or cancellation of pachinko hall licences or pachinko hall operations, and other related disciplinary actions against pachinko hall operators and pachinko hall managers.

Police personnel

Police personnel are overseen by the National Police Agency and are permitted to enter pachinko halls to the extent necessary for enforcing the Amusement Business Law.

Prefectural governments

Prefectural governments set the standards for the hours of operation of pachinko halls, the level of noise and vibration around pachinko halls and collect fees which are necessary for certification, approval and examination of pachinko halls and pachinko and pachislot machines. Such standards must at least meet the minimum standards set out under the Amusement Business Law.

Security Communications Association* (保安通信協会)

The Security Communications Association* (保安通信協会) is responsible for examining machines to ensure that they comply with Amusement Business Law standards in their technical specifications and also to ensure that they do not promote a “passion for gambling”.

Prefectural Entertainment Environment Cleanup Association* (都道府県風俗環境浄化協会)

The Prefectural Entertainment Environment Cleanup Association* (都道府県風俗環境浄化協会) works under the Prefectural Public Safety Commission to organise personnel training and promote compliance with the Amusement Business Law.

Minors Orientation Committee* (青少年健全育成審議会)

The Minors Orientation Committee* (青少年健全育成審議会) works under each Prefectural Public Safety Commission to prevent minors from being involved in any “amusement business”.

APPLICABLE LAWS AND REGULATIONS

C. LEGALITY OF PACHINKO BUSINESSES AND THE THREE PARTY SYSTEM

1. Penal Code

Under the Penal Code, gambling is a criminal offence. There are three types of gambling offences, namely: (1) “gambling”, punishable by a fine of up to ¥500,000 (Article 185); (2) if gambling is habitual, “habitual gambling”, punishable by up to three years’ imprisonment (Article 186); and (3) if a place is run for gambling or organises a group of habitual gamblers, “running a gambling place for the purpose of gain”, punishable by between three months’ and five years’ imprisonment.

The Penal Code provides for certain exemptions for this gambling offence, such as activities that are expressly allowed under Japan laws and regulations (such as small-scale lotteries and public horse-racing). Significantly, Article 185 of the Penal Code exempts activities involving “betting for a thing that is provided for temporary amusement”. Therefore, as a pachinko hall operator, we must conduct our operations such that we only offers prizes that fall within the scope of “a thing that is provided for temporary amusement”.

The Supreme Court (最高裁判所) (the highest court in Japan) has stated in their judgment that, if an operator of a gaming place operates its gaming business in accordance with the conditions and restrictions applicable to its operating licence duly granted by the Public Safety Commission under the then-equivalent of the Amusement Business Law, such business activities can be deemed as “an activity involving betting for a thing which is provided for temporary amusement” under Article 185 of the Penal Code. Therefore, according to Article 185 of the Penal Code, such business activities do not constitute any gambling offence under the Penal Code.

In addition, on 25 June 2003, the National Police Agency issued a statement in response to questions raised by the “Group of Diet Members Considering Casino as an International Tourism Industry” (国際観光産業としてのカジノを考える議員連盟). This statement essentially agreed with the Supreme Court’s (最高裁判所) ruling and commented in support of the Three Party System in terms of both the Penal Code and the Amusement Business Law. The comments state that (among others): (1) pachinko halls that operate their business within the scope provided under the Amusement Business Law shall not be considered to have committed any gambling offence under the Penal Code; and (2) since the Amusement Business Law only regulates pachinko hall operators (and not persons or entities unrelated to the pachinko hall operator), third parties are not prohibited from purchasing prizes from pachinko hall customers.

Our Japan Legal Adviser, after conducting due diligence as described in “— C. Legality of Pachinko Businesses and the Three Party System — 3. The Three Party System — Independence — Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor” below, has confirmed that we have duly obtained and maintained at all times a valid operating licence under the Amusement Business Law for all of our halls, our pachinko and pachislot hall operations (including the prizes offered by each of our halls) is conducted in accordance with the conditions and restrictions applicable to such operating licence, and we have not committed any material breach of the Amusement Business Law, thus, our pachinko and pachislot hall operations do not constitute any gambling offence under, and do not violate, the Penal Code.

APPLICABLE LAWS AND REGULATIONS

2. Amusement Business Law and Local Regulations

The Amusement Business Law sets regulations for “amusement businesses”, such as pachinko hall operators, that they must comply with in order to operate their business. See “— D. Other Regulations on Pachinko Businesses” for more details about the requirements under the Amusement Business Law.

Article 23 of the Amusement Business Law prohibits pachinko hall operators from being involved in the exchange of prizes for cash or securities by either: (1) providing cash or securities as prizes; or (2) directly repurchasing from customers the prizes provided to them for cash or securities. A breach of Article 23 may cause the pachinko hall operator to be subject to suspension of business for a period ranging from 20 days to 180 days as an administrative sanction. In addition, a penalty of imprisonment up to six months, or a fine of ¥1 million may be imposed as criminal sanctions. If the pachinko hall operator is a company, the hall operator itself will only be subject to the fine, while person(s) who committed the breach as its representative, attorney or employee will be subject to imprisonment and/or the fine.

In accordance with industry practice, we strictly do not provide cash or securities to our customers, but only general prizes and G-prizes. Our Japan Legal Adviser, after conducting due diligence searches as described in “— C. Legality of Pachinko Businesses and the Three Party System — 3. The Three Party System — Independence — Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor” below, has confirmed we have fully complied with such industry practice and that we have never been, and are not currently, in breach of Article 23 of the Amusement Business Law.

Significantly, there are no prohibitions against: (1) customers selling G-prizes (exchanged with balls or tokens in a pachinko hall) to a third party who is not the pachinko hall operator; or (2) pachinko hall operators purchasing G-prizes from a third party who is not their customer. However, it should be noted that most prefectural governments have passed local regulations ancillary to the Amusement Business Law, which also prohibit pachinko hall operators from causing a third party to repurchase G-prizes from their customers (the “**Third Party Local Regulations**”) (who merely acts as the operator’s agent or an intermediary in the repurchase process).

In fact, the National Police Agency has commented, including in its statement on 25 June 2003 in response to questions raised by the “Group of Diet Members Considering Casino as an International Tourism Industry” (国際観光産業としてのカジノを考える議員連盟) that the Amusement Business Law and the Third Party Local Regulations only regulates “amusement businesses” (such as pachinko hall operators) and not persons or entities unrelated to them, thus, an unrelated third party is not prohibited from purchasing G-prizes from customers. Accordingly, the National Police Agency’s prevailing interpretation in its administration of the Amusement Business Law and the Third Party Local Regulations is that it is legal for a pachinko hall operator to purchase G-prizes from an unrelated third party, provided that such G-prizes are commingled with G-prizes from other halls through the hands of such unrelated third party.

APPLICABLE LAWS AND REGULATIONS

3. The Three Party System

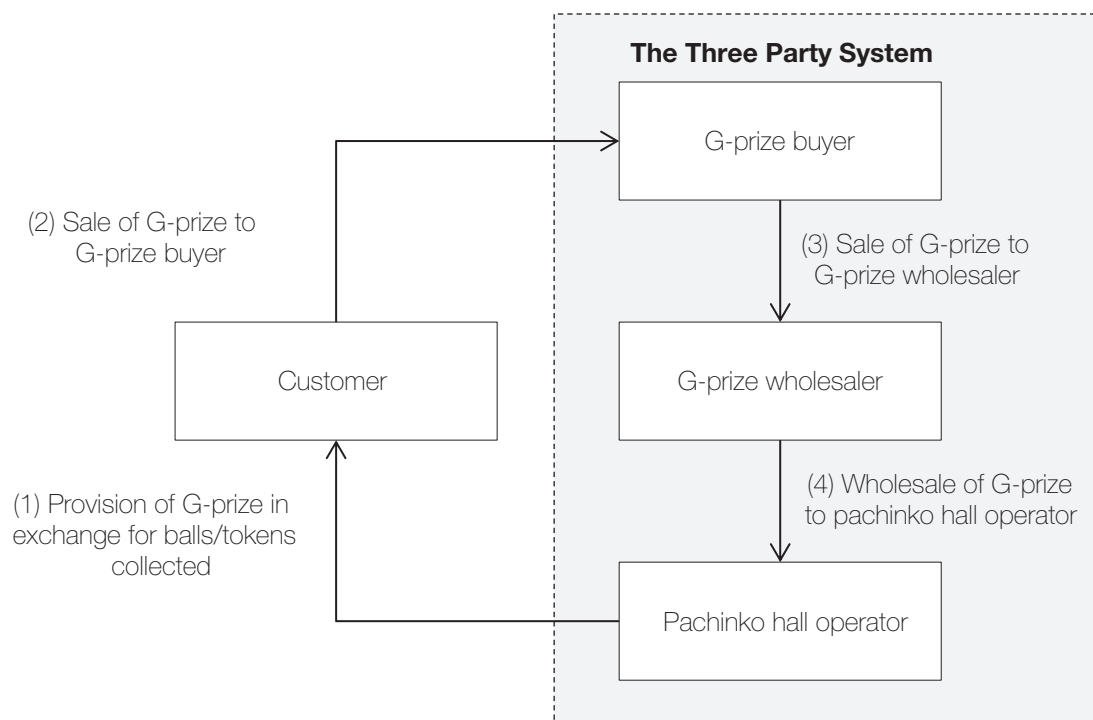
In order to ensure compliance with the Amusement Business Law, the Third Party Local Regulations and the National Police Agency's prevailing interpretation in its administration of the above, the pachinko industry has developed a practice, for the sale and purchase of G-prizes exchanged by a customer by playing at a hall, through unrelated third parties. This industry practice is commonly referred to as the "Three Party System".

Parties

The parties under the "Three Party System" consist of:

1. **Pachinko hall operators.** These operate pachinko halls that provide pachinko and pachislot games, and also purchase G-prizes from G-prize wholesalers. Customers can play these games and exchange their balls or tokens in these halls for prizes, such as G-prizes;
2. **G-prize buyers.** These are typically companies or sole proprietorships. Customers can, but are not obliged to, sell their G-prizes (that they obtained from pachinko halls) to them for cash. G-prize buyers will then further sell these G-prizes to G-prize wholesalers; and
3. **G-prize wholesalers.** These are typically companies and they purchase G-prizes from G-prize buyers, and then further sell them to pachinko hall operators.

The diagram below shows the general flow of G-prizes within the Three Party System and with customers:



APPLICABLE LAWS AND REGULATIONS

While the purchase price for transactions marked (2), (3) and (4) in the above diagram is generally similar, G-prize wholesalers also typically receive a monthly fee from hall operators and G-prize buyers also typically receive a monthly fee from the relevant G-prize wholesaler, for their respective services rendered for such relevant transactions. According to industry practice, the monthly fee paid by hall operators to G-prize wholesalers is greater than that paid by G-prize wholesalers to their G-prize buyers. As for transaction (1), depending on the location of the hall and competition in that area, a mark-up on the G-prizes (set by the pachinko hall operator) may be added over the purchase price of the G-prize paid by the pachinko hall operator to the G-prize wholesaler, when the customer exchanges his balls or tokens for G-prizes. For instance, assuming a 10% G-prize mark up, a customer will need 1,100 ¥1 balls to exchange a G-prize with a cost of ¥1,000 from the operator.

Further, G-prize wholesalers may purchase G-prizes from various G-prize buyers, and they may also sell G-prizes to various pachinko hall operators if the G-prize is of the same type in design and appearance. As such, all the G-prizes purchased by the wholesaler from multiple G-prize buyers are commingled, meaning that the G-prizes that are sold to the pachinko hall by the wholesaler are not necessarily the same G-prizes provided by the pachinko hall to its customers.

Independence

Under the Three Party System, pachinko hall operators (such as ourselves), must be independent of each of: (1) the G-prize wholesalers engaged by them; and (2) G-prize buyers engaged by such G-prize wholesalers. This ensures that, from the pachinko hall operators' perspective, G-prize wholesalers and G-prize buyers are unrelated third parties from the pachinko hall operator.

Independence between pachinko hall operators and G-prize wholesalers

A G-prize wholesaler is independent and an unrelated third party to the pachinko hall operator if:

1. neither party may have the ability to exercise control, whether directly or indirectly, over the other, through (i) any relationship or connection between the personnel of the pachinko hall operator and the G-prize wholesaler, (ii) any equity holding or any other capital relationship or connection between the pachinko hall operator and the G-prize wholesaler, or (iii) any contract or other agreement between the pachinko hall operator and the G-prize wholesaler; and
2. G-prizes to be purchased are of market value, meaning that G-prizes must have intrinsic value (which can be satisfied by the metal (such as gold) embedded in the G-prize).

Each of these factors is satisfied with respect to all of our pachinko halls.

APPLICABLE LAWS AND REGULATIONS

Our Japan Legal Adviser, after conducting due diligence as described in “— C. Legality of Pachinko Businesses and the Three Party System — 3. The Three Party System — Independence — Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor” in this section below, has also determined that each of our pachinko halls is independent as evaluated under the factors listed above from each of our G-prize wholesalers.

Independence between pachinko hall operators and G-prize buyers

A G-prize buyer is independent and an unrelated third party to the pachinko hall operator if:

1. neither party may have the ability to exercise control, whether directly or indirectly, over the other, through (i) any relationship or connection between the personnel of the G-prize buyer and the pachinko hall operator, (ii) any equity holding or any other capital relationship or connection between the G-prize buyer and the pachinko hall operator, or (iii) any contract or other agreement between the G-prize buyer and the pachinko hall operator;
2. G-prizes to be purchased are of market value, meaning that G-prizes must have intrinsic value (which can be satisfied by the metal (such as gold) embedded in the G-prize); and
3. G-prizes are not directly returned from or sold by the G-prize buyer to the pachinko hall operator (but, for example, are instead sold by the G-prize buyer to a G-prize wholesaler who in turn commingles the G-prizes that it has purchased from multiple sources (including other G-prize buyers), thus, making it impossible to identify which hall the G-prizes came from).

Each of these factors is satisfied with respect to all of our pachinko halls.

Our Japan Legal Adviser, after conducting due diligence as described in “— C. Legality of Pachinko Businesses and the Three Party System — 3. The Three Party System — Independence — Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor” in this section below, has confirmed that each of our pachinko halls is independent as evaluated under the factors listed above from each of the G-prize wholesalers (engaged by us) G-prize buyers (engaged by such G-prize wholesalers).

Our internal control procedures to ensure our independence

We have obtained written confirmations issued to us and the Sole Sponsor from all our current G-prize wholesalers regarding their independence (based on criteria even stricter than that set out above) from: (1) us; and (2) any G-prize buyers engaged by them who have G-prize buying shops near our halls. These confirmations also covered the following matters:

- a complete and accurate list of all G-prize buyers engaged by them who have G-prize buying shops near our halls;

APPLICABLE LAWS AND REGULATIONS

- to the best of their knowledge, the content of the confirmations issued by such G-prize buyers (as described below) to us and the Sole Sponsor is true and accurate;
- written undertakings to conduct their own regular background checks against any G-prize buyers engaged by them in order to monitor any independence issues between such G-prize buyers and themselves, and if these G-prize wholesalers become aware of any such independence issues, they will inform us and resolve such issues immediately in order to ensure compliance with the Three Party System;
- written undertakings to report to us in a timely manner any change in their shareholding structure and composition of their board of directors, or if they become aware of any change in the shareholding structure or composition of the board of directors of any G-prize buyers engaged by them or any other matters that may affect their independence or the independence of such G-prize buyers within the Three Party System; and
- to the best of their knowledge, they are not aware that any such G-prize buyers are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force. Further, neither they nor any of their representatives, directors, statutory auditors, executive officers or shareholders are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force.

We have obtained written confirmations issued to us and the Sole Sponsor from all such G-prize buyers regarding their independence (based on criteria even stricter than that set out above) from: (1) us; and (2) any G-prize wholesalers engaged by us. These confirmations also covered the following matters:

- neither they nor any of their representatives, directors, statutory auditors, executive officers or shareholders are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force;
- to the best of their knowledge, they are not aware that any such G-prize wholesalers are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force; and
- they have undertaken to the G-prize wholesaler that engages them that they shall report to such G-prize wholesaler in a timely manner any change in their shareholding structure or composition of board of directors or any other matters that may affect their independence within the Three Party System.

We have also obtained through our current G-prize wholesalers a list of the shareholders of the G-prize buyers engaged by them.

We will require our G-prize wholesalers to re-issue, and to request their G-prize buyers to re-issue, these confirmations to us every year.

APPLICABLE LAWS AND REGULATIONS

In addition, we have also adopted the following internal control procedures to ensure the independence of our pachinko halls from each of our G-prize wholesalers and G-prize buyers engaged by them:

- we regularly obtain from each of our G-prize wholesalers a list of the shareholders (or ultimate owners) and directors of both themselves and the G-prize buyers engaged by them;
- we will annually obtain commercial registers of all our G-prize wholesalers and the G-prize buyers engaged by them (provided that they are legal corporate entities) to review the composition of their board of directors;
- we will engage independent third parties to perform annual searches on the shareholding structure and list of directors (if available) for all of our G-prize wholesalers and G-prize buyers engaged by them;
- we require our Directors, senior management and Shareholders to confirm that they are independent of our G-prize wholesalers and such G-prize buyers (based on the criteria set out above), and to notify us immediately if they become aware of any potential independence issues;
- we will provide training on the Three Party System to our employees on a regular basis to ensure that they do not engage with G-prize wholesalers or G-prize buyers engaged by them, and to prevent them from unknowingly establishing a relationship with them. For example, all our Directors and senior management attended a training conducted by our Japan Legal Adviser in December 2014 on the legal, regulatory and practice requirements under the Penal Code, the Amusement Business Law and the Third Party Local Regulations, including the independence requirements within the Three Party System;
- we require that none of our management, Directors or staff are engaged in the G-prize buying business; and
- as our pachinko and pachislot hall operations are monitored by the Prefectural Public Safety Commission in each relevant prefecture, in order to prevent any conflicts of interest that might otherwise arise and for improved corporate governance, none of our Directors or senior management has been, or is, a police officer in Japan and we require them to confirm so to us.

For our internal control procedures in relation to potential new G-prize wholesalers, see “Business — Pachinko and Pachislot Hall Operations — Three Party System — Risk Management”.

APPLICABLE LAWS AND REGULATIONS

Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor

Our Japan Legal Adviser and Sole Sponsor has conducted the following due diligence regarding our independence from each of our G-prize wholesalers and the G-prize buyers engaged by them:

- hosted a training session conducted by our Japan Legal Adviser in December 2014 for all our Directors and senior management on the legal, regulatory and practice requirements under the Penal Code, the Amusement Business Law and the Third Party Local Regulations, including the independence requirements within the Three Party System;
- obtained confirmations issued to us and the Sole Sponsor from our Directors and senior management regarding (among others) their attendance and understanding of the relevant legal, regulatory and practice requirements (including on independence) explained at the above training session;
- obtained confirmations issued to the Sole Sponsor from our Company, Directors, Shareholders and senior management regarding (among others) the Group's and their independence from each of our G-prize wholesalers and the G-prize buyers (engaged by our G-prize wholesalers);
- interviewed all our Directors and senior management regarding (among others) their understanding of the relevant legal, regulatory and practice requirements (including on independence) explained at the above training session, their relationship(s) with our G-prize wholesalers and also the G-prize buyers (engaged by our G-prize wholesalers), and ultimately to confirm the Group's and their independence from each such party;
- interviewed our G-prize wholesalers (through their legal representative, a director or other responsible management personnel), regarding (among others) their relationship(s) with our Group and also the G-prize buyers (engaged by them), and ultimately to confirm their independence from each such party;
- interviewed the G-prize buyers (engaged by our G-prize wholesalers) (through their legal representative, a director or other responsible management personnel) regarding (among others) their relationship(s) with our Group and also our G-prize wholesalers, and ultimately to confirm their independence from each such party;
- reviewed all agreements between us and our G-prize wholesalers, namely purchase agreements for G-prizes, lease agreements and purchase agreements for miscellaneous goods and services. See "Business — Pachinko and Pachislot Hall Operations — Three Party System — Agreements between us and G-prize wholesalers" for details on such agreements, including our Japan Legal Adviser's confirmation that such agreements do not affect our independence;

APPLICABLE LAWS AND REGULATIONS

- reviewed the written confirmations issued to us and the Sole Sponsor from all of our G-prize wholesalers and the G-prize buyers (engaged by our G-prize wholesalers) (except for those engaged in relation to our one hall that has been permanently closed due to the Great East Japan Earthquake) regarding (among others) their independence within the Three Party System. See “— C. Legality of Pachinko Businesses and the Three Party System — 3. The Three Party System — Independence — Our internal control procedures to ensure our independence” for details of these confirmations;
- reviewed all commercial registers of our G-prize wholesalers and such G-prize buyers (engaged by our G-prize wholesalers) that are corporations in order to identify (among others) to identify any overlap of directors; and
- obtained a list of the Group’s representatives, directors, statutory auditors, executive officers and shareholders through the Group’s commercial registers and share registers.

Legality of our pachinko and pachislot hall operations and the Three Party System

Our Japan Legal Adviser, having conducted due diligence described above and reviewed the relevant court cases, governmental statements and practices, has advised us that:

1. the National Police Agency has never taken any action against the legality of the pachinko industry, as a whole, under the Penal Code, the Amusement Business Law, the Third Party Local Regulations or otherwise;
2. as long as our pachinko and pachislot hall operations are conducted under the Three Party System, in accordance with prevailing standard industry practices in the pachinko industry, and the independence factors described above are satisfied, our pachinko and pachislot hall operations will not violate the Penal Code, the Amusement Business Law or the Third Party Local Regulations;
3. our pachinko and pachislot hall operations (as carried out in the context of the Three Party System) do not contravene the Penal Code, the Amusement Business Law, the Third Party Local Regulations or any of the operating licences of our halls; and
4. as at the Latest Practicable Date, we have not been found to be in any material breach of the Penal Code, the Amusement Business Law, the Third Party Local Regulations or any of the operating licences of our halls.

APPLICABLE LAWS AND REGULATIONS

D. OTHER REGULATIONS ON PACHINKO BUSINESSES

1. Pachinko Hall Business Licence (“Operating Licence”)

A pachinko hall business is considered an “amusement business” under the Amusement Business Law and other relevant laws, regulations, and prefectural ordinances. Under the Amusement Business Law, a pachinko hall operator must, prior to establishing each pachinko hall, obtain an Operating Licence from the relevant Prefectural Public Safety Commission* (都道府県公安委員会). Once granted, the Operating Licence will remain effective unless and until it is cancelled by the Prefectural Public Safety Commission pursuant to the Amusement Business Law.

As at the Latest Practicable Date, we owned 56 halls and had obtained and directly hold a licence (through Niraku Corporation) for each of these halls, each of which is currently valid.

Application

When considering an application for an Operating Licence, the Prefectural Public Safety Commission will consider the following factors under the Amusement Business Law:

- whether the business owner/operator is, with reference to past offences or other instances of regulatory non-compliance, a fit and proper person to hold an Operating Licence (the “**Fit and Proper Person Requirements**”);
- the proposed place of business, including its structural integrity and other technical building specifications;
- the location of the intended place of business, including town planning and area zoning considerations and proximity to schools and hospitals; and
- the compliance with legal specifications of the pachinko and pachislot machines intended to be installed at the proposed hall.

Conditions

Operating Licences carry certain restrictions. For example, the Prefectural Public Safety Commission must grant prior approval to any corporate restructuring or corporate succession carried out by a holder of an Operating Licence (the “**Licence Holder**”) in the relevant prefecture. Any Operating Licence transferee is subject to the same requirements as the original Licence Holder. This prevents unauthorised transfer of an Operating Licence. Also, another condition is that pachinko and pachislot machines installed in pachinko halls do not encourage a “passion for gambling”. See “— D. Other Regulations on Pachinko Businesses — 2. Pachinko and Pachislot Machine Regulations” in this section below for details.

APPLICABLE LAWS AND REGULATIONS

Also, the Prefectural Public Safety Commission may, at its discretion and at any time, impose additional conditions on the Operating License as it considers necessary to maintain certain moral decency standards within the pachinko hall and broader food and beverage industry, or otherwise for the protection of minors. For example, the Operating Licences for all our halls in Tokyo (東京都) have a standard condition (that applies to all halls for all pachinko hall operators), which states that players can only play one machine at a time, and players must not use any equipment that will affect the handle of the playing machines. Also, the Operating Licence for two of our halls (namely, in Fukushima Prefecture (福島県) and Kanagawa Prefecture (神奈川県)) also have another condition that restricts these halls from expanding to within 100 metres of a school. Save for the above, there are no other conditions in the Operation Licences of our halls.

Directives, sanctions, cancellation or suspension

The Prefectural Public Safety Commission has broad authority to issue directives or impose sanctions on a Licence Holder, including its business representatives and employees, in circumstances where there has been a breach of the Amusement Business Law or other civil and criminal laws.

The Prefectural Public Safety Commission may cancel an Operating Licence, or issue a directive to suspend operations carried on thereunder, where:

- it has been obtained through fraudulent or other illegal means;
- the Licence Holder no longer satisfies the Fit and Proper Person Requirements;
- the pachinko business has not commenced within six months from the grant of an Operating Licence or there has been any suspension of operations for more than six months without justifiable grounds;
- the whereabouts of the Licence Holder is unknown for more than three months;
- the Licence Holder breaches any legislation pertaining to the business which is the subject of the Operating Licence, and such violation is likely to either cause substantial harm to a good and quiet moral environment, or to violate the rights of minors; or
- the Licence Holder fails to comply with a directive of the Prefectural Public Safety Commission or a license condition.

In the event that the pachinko operator has an objection to the cancellation or suspension of an Operating Licence, it may, within six months from such decision, bring an action with the relevant court for the revocation of the administrative decision.

APPLICABLE LAWS AND REGULATIONS

2. Pachinko and Pachislot Machine Regulations

The Amusement Business Law, the Enforcement Ordinance and the enforcement regulations prescribed under the Amusement Business Law, also regulate pachinko and pachislot machines installed in pachinko halls by the Licence Holder. One of the Operating Licence conditions is that pachinko and pachislot machines installed in pachinko halls do not encourage a “passion for gambling”.

Pachinko and pachislot machines are subject to certain restrictions, such as those listed below, in order to comply with this condition:

- limitations on the value of pachinko balls or pachislot tokens that may be put into play per minute (namely, ¥400);
- limitations on the number of pachinko balls or pachislot tokens that may be won in various modes of play;
- limitations on the total number of pachinko balls or pachislot tokens that may be won over a continuous period of play;
- the size of the pockets which trigger jackpot mode, as compared to the size of the pachinko ball, may not be significantly larger or smaller than the customary size;
- pachinko balls may not be automatically fired into the field of play without the player directly controlling the shooting strength; and
- the machine may not be capable of easily being illegally modified or otherwise changed.

The payouts of pachinko balls and pachislot tokens resulting from “jackpot” or “bonus” modes as a percentage of total balls or tokens played is limited by law so as to discourage playing with the sole purpose of winning or “gambling”.

For pachinko balls, the key required ranges on payout ratios are that the number of balls that the pachinko machine may pay out shall be: (1) less than or equal to 15 times the number of balls put into play at any time; (2) less than or equal to 3 times the number of balls put into play over a continuous 1-hour period; and (3) between 0.5 to 2 times the number of balls put into play over a continuous 10-hour period.

For pachislot tokens, the key required ranges on payout ratios are that the number of tokens that the pachislot machine may pay out shall be: (1) less than or equal to 15 times the number of tokens put into play at any time; (2) less than or equal to 3 times the number of tokens played over 400 consecutive plays; (3) less than or equal to 1.5 times the number of tokens played over 6,000 continuous plays; and (4) between 0.55 to 1.2 times the number of tokens played over 17,500 continuous plays.

APPLICABLE LAWS AND REGULATIONS

A person who intends to manufacture or import a pachinko or pachislot machine or to install it may, but is not legally required to, apply for an inspection of the machine by the Security Communications Association* (保安通信協会) for specifications of such imported or manufactured pachinko or pachislot machine. A machine manufacturer typically submits its machine prototypes to testing by the Security Communications Association* (保安通信協会). Machine prototypes that pass such testing receive certificates. Each machine subsequently manufactured according to that prototype will also have a certificate showing its compliance with such testing. Purchasing machines from manufacturers that have received this approval reduces the risk of installing machines that do not comply with the legal requirements. A pachinko operator that intends to increase or change its number of machines, including the transfer of a machine to a different pachinko hall, must obtain prior written permission from the Prefectural Public Safety Commission. Also, before any machine is delivered, the prefectural police must certify the eligibility and compliance of the machine or replacement part, which is evidenced by a “Notice of Inspection” issued to the manufacturer (for new machines) or dealer (for second-hand machines). A similar notice is issued when machine parts are replaced. In addition, prior to operation of a new or second-hand machine, the pachinko hall must submit an application to the local police authority to request an inspection, upon completion of which an approval is granted and operation of the machine may begin. The police may inspect the machines at random after installation in the pachinko hall.

As we only purchase machines from manufacturers that submit their machine prototypes for testing by the Security Communications Association* (保安通信協会), our pachinko and pachislot machines each have a certificate demonstrating compliance with those tests and have passed all inspections conducted by the relevant Prefectural Public Safety Commission during the Track Record Period.

3. Machine Pin Angle Maintenance and Adjustments

Under Articles 9 and 20 of the Amusement Business Law, any “change” in a game machine installed in a pachinko hall requires the prior permission of the Public Safety Commission, except that, for minor changes, a notification after such minor change to the Public Safety Commission is sufficient.

Pin angles impact the distance between the ends of each pin, which in turn directly influences the likelihood that balls fall into the designated pockets that release bonus balls, trigger jackpots, or conversely, fall into the trap and become lost. Therefore, pin angles have a direct impact on payout ratios and ultimately gross payouts and revenue from pachinko and pachislot business. However, pin angles often shift during the normal course of play on a pachinko machine as the pachinko balls cascade down, through and collide into the pins in the playing field, which consequentially changes payout ratios of pachinko machines. As mentioned above, there are required ranges under law for payout ratios. Therefore, consistent with industry practice, we generally perform regular maintenance and adjustments on the angle of the pins of our pachinko machines in order to ensure full and consistent compliance with such required ranges on payout ratios.

APPLICABLE LAWS AND REGULATIONS

Our Japan Legal Adviser has advised us that such pin angle maintenance and adjustments will not constitute a “change” in a game machine that requires prior approval of or subsequent notice to the Public Safety Commission under Articles 9 and 20 of the Amusement Business Law, if the following three criteria are satisfied:

- (1) such pin angle maintenance and adjustments do not involve any bending or other modification of the shape of the pins;
- (2) the purpose of such pin angle maintenance and adjustments is to ensure compliance with the relevant required ranges and to maintain an average payout ratio for each pachinko machine that is in compliance with the relevant required ranges; and
- (3) the payout ratio of the pachinko machine for which the Maintenance and Adjustment of Pins has been completed remains within the required range.

Provided that the above three criteria are satisfied, pachinko hall operators may conduct such pin angle maintenance and adjustments anytime. Our Japan Legal Adviser, after conducting due diligence investigations, has confirmed that our Group has strictly complied with the above-mentioned three criteria in respect of our pin angle maintenance and adjustments and that they: (1) do not constitute a “change” in a game machine (whether major or minor) that requires prior approval of or subsequent notice to the Public Safety Commission under Articles 9 and 20 of the Amusement Business Law; and (2) are in full compliance with the Amusement Business Law and the Enforcement Ordinance.

4. Adjustments of Payout Settings on Pachislot Machines

A player wins bonus pachislot tokens if the images on the reels form a winning combination. The amount of payouts for a particular winning combination may differ from machine to machine, as each pachislot machine has adjustable payout settings. These settings are designed and pre-set solely by the machine manufacturer, come in-built into the machine and can only be adjusted by the operator. There are a range of payout settings made by the machine manufacturer, all of which must fall within the range required under the Enforcement Ordinance. For example, the number of tokens that a pachislot machine may pay out must be between 0.55 to 1.2 times the number of tokens put into play over 17,500 continuous plays. The machine manufacturer must ensure such payout settings are in full compliance with these required ranges in order for the machine to pass the examination on specifications etc. as required under the Amusement Business Law.

Consistent with industry practice, the Group regularly adjusts these payout settings of their pachislot machines in order to improve the business performance of their halls. Such adjustments of payout settings for our pachislot machines are in full compliance with the Amusement Business Law and the Enforcement Ordinance.

APPLICABLE LAWS AND REGULATIONS

5. Playing Costs, Prize Offerings and Prize Value

The Amusement Business Law and the Enforcement Ordinance regulate pachinko and pachislot playing costs, prize offerings and the upper limit of the value of prizes.

The Enforcement Ordinance prescribes the following maximum playing costs: (1) for pachinko machines, ¥4 per ball; and (2) for pachislot machines, ¥20 per token.

The maximum value of prizes offered is ¥9,600 (before consumption tax), and the types of prizes are generally limited to everyday general consumer goods, such as snacks, beverages, cigarettes and sundry household items. Our Japan Legal Adviser has confirmed that G-prizes, which include decorative cards with a small embedded piece of metal (such as gold) and coin shaped pendants of metal (such as gold), comply with this regulation. The value of balls or tokens required to collect a prize, as listed at the hall operator's prize exchange counter (which, at the hall operator's discretion, may reflect a mark-up over the cost of the prizes) must be equivalent to the value of the balls or tokens actually presented by the customer to exchange such prizes. In addition, in order for the prizes to meet the diverse range of expectations of customers, the hall must offer a wide range of items suitable for everyday use.

The Amusement Business Law prohibits Licence Holders from:

- (i) offering cash or securities as prizes;
- (ii) directly repurchasing from customers the prizes provided to them for cash or securities; and
- (iii) allowing customers to take pachinko balls, pachislot tokens or any other similar objects provided for playing pachinko or pachislot outside the hall.

Breaching any of these prohibitions under the Amusement Business Law may subject the pachinko operator to: (1) an administration sanction, namely business suspension for 20 to 180 days for (i) or (ii) above, and 5 to 40 days for (iii) above; and (2) a criminal sanction, namely imprisonment up to six months, as well as a fine of ¥1 million for breaches of (i) or (ii) above, and a fine of ¥500,000 for breaches of (iii) above. If the pachinko hall operator is a company, the hall operator itself will only be subject to the fine, while person(s) who committed the breach as its representative, attorney or employee will be subject to imprisonment and/or the fine.

6. Membership Systems

The Amusement Business Law prohibits Licence Holders from issuing any written documentation indicating that pachinko balls or pachislot tokens are being held for a customer. However, Article 16-9(2) of the Standards for the Interpretation and Operation of the Amusement Business Law issued by the National Police Agency provides that a membership card does not constitute written documentation of the hall holding balls or tokens for a customer if the number of such balls or tokens is not recorded on the card itself and is stored only on computers in the halls.

APPLICABLE LAWS AND REGULATIONS

Our Japan Legal Adviser has verbally consulted with the National Police Agency regarding the relevant provisions of the Amusement Business Law and Article 16-9(2) of the Standards for the Interpretation and Operation of the Amusement Business Law and has confirmed that our membership system complies with such laws and regulations, as it does not constitute written documentation of balls or tokens being held for customers since the number of balls or tokens held by a particular member is recorded only on our IT systems, and strictly not on the membership cards themselves.

7. Operating Hours

The Amusement Business Law restricts pachinko hall opening hours to the period from sunrise to 12:00 a.m. However, each prefecture is permitted to impose more stringent limits on operating hours and such additional restrictions are common. For example, halls in Tokyo are prohibited from operating between 11:00 p.m. and 10:00 a.m. the following day. There are no such additional restrictions in Fukushima Prefecture (福島県).

8. Environmental Regulations

Pursuant to Amusement Business Law and local ordinances, a Licence Holder must conduct business in such a way as not to cause noise or vibrations (limited to voices of people and other noises and vibrations that are part of operating a business) in the area surrounding the place of business that exceed the limits specified by prefectural ordinances.

The Amusement Business Law prescribes the following noise limits:

Region	Numerical Value		
	Daytime ⁽¹⁾	Evening ⁽²⁾	Late Night ⁽³⁾
(1) In areas specified by a particular prefecture in a prefectural ordinance as necessary to be especially quiet due to condensed housing or other similar areas	55 decibels	50 decibels	45 decibels
(2) In areas specified by a particular prefecture in a prefectural ordinance as necessary not to have extreme noise due to condensed stores and other similar areas	65 decibels	60 decibels	55 decibels
(3) Areas other than the areas in (1) and (2) above	60 decibels	55 decibels	50 decibels

⁽¹⁾ "Daytime" means sunrise until sunset

⁽²⁾ "Evening" means sunset until 12:00 a.m.

⁽³⁾ "Late Night" means 12:00 a.m. until sunrise

APPLICABLE LAWS AND REGULATIONS

Also, under the Amusement Business Law, each pachinko hall must have the necessary equipment necessary to maintain illumination in each hall at more than 10 lux.

9. Advertising and Promotion Regulations

The Amusement Business Law requires a Licence Holder to advertise or promote their business in such a way that it will not likely interfere with the peace and quiet surrounding the place of business. Under the Standards for the Interpretation and Operation of the Amusement Business Law published by the National Police Agency, the following methods of advertisement are likely to constitute an “interference with peaceful and quiet surroundings”:

- displaying sexually explicit or other adult material;
- advertising or promoting the illegal maintenance and adjustments of pins, illegal alterations of payout probabilities or otherwise encouraging customers’ “passion for gambling”; or
- noise levels beyond prescribed limits in public areas.

Failure to comply with such restrictions may result in various penalties, the most severe being a cancellation of the Operating Licence.

10. Prohibition on Minors

Customers of pachinko halls must be at least 18 years of age. The Amusement Business Law provides that the Licence Holder must post a sign at the entrance to the place of business prohibiting entry by those under the age of 18. The sign must be posted so as to be easily seen by the public.

11. Building and Construction Regulations

If a Licence Holder adds to the structure, makes structural changes or undertakes any other construction or changes to the facilities of the place of business, it must obtain prior permission from the Prefectural Public Safety Commission, with the exception of some specified minor changes.

Examples of structural or equipment modifications that require permission include extensive repairs to the place of business, changes to the location of guest rooms or floor space, and changes to the facilities such as adding walls or Japanese-style sliding doors to partition the interior of the place of business.

APPLICABLE LAWS AND REGULATIONS

We must comply with the Building Standard Act* (建築基準法) of Janpan (Act No. 201 of 1950), which requires any entity that constructs, substantially repairs or remodels, whether by itself or through a third-party contractor, any building that is larger than a certain scale or that is located in certain designated areas to obtain a certificate of prior confirmation for the planned construction, repair or remodelling as well as a certificate of completion thereof from an inspector appointed by the local authorities.

We must also comply with the City Planning Act* (都市計画法) of Janpan (Act No. 100 of 1968), which designates areas where certain usage is not allowed. No Operating Licence will be granted unless the pachinko hall is located in an area where it is permitted under the City Planning Act* (都市計画法) (Act No. 100 of 1968).

E. AML

The AML laws in Japan do not impose any specific obligations on pachinko hall operators. Unlike casino gaming, where customers purchase casino chips that have little or no intrinsic value but have high face values and have the potential to win or lose substantial sums in a short period of time, pachinko presents the opportunity over a relatively long period of time to win G-prizes that have a limited intrinsic value. The inherent mechanical limitations on pachinko ball and pachislot token dispensers render it extremely difficult for a pachinko player to obtain the number of pachinko balls or pachislot tokens necessary to redeem G-prizes of significant value in a short period of time. Thus, a customer seeking to launder even an insignificant amount of cash would need to spend at least several hours exchanging the cash into balls or tokens in addition to a considerably longer period of time putting such balls or tokens into play in a machine.

Furthermore, we do not allow customers to exchange balls or tokens into prizes without first putting them into play in the machines and we have put in place internal policies and internal control measures to prevent customers from violating this requirement. Our hall staff closely monitors the number of balls rented and the number of balls played in each of the machines. Any irregularities in such numbers are closely followed up by hall staff. Surveillance cameras are also installed in the pachinko hall, and hall staff patrol the pachinko hall during its operating hours in order to detect any suspicious activity. Thus, it would be inefficient and highly impractical to engage in money laundering activities through pachinko or pachislot. For more information on our AML procedures, see “Internal Controls and Anti-Money Laundering – Internal Controls on Money Laundering”.

F. LABOUR

Act on Employment Promotion etc. of Persons with Disabilities* (障害者の雇用の促進等に関する法律) of Janpan (Act No. 123 of 1960) requires that at least 2% of the employees of any employers with more than 50 employees must be handicapped persons. Handicapped persons hired by a subsidiary will count towards this requirement for its holding companies.

APPLICABLE LAWS AND REGULATIONS

Also, the Industrial Safety and Health Act* (労働安全衛生法) of Janpan (Act No. 57 of 1972) also provides standards for employers regarding the health and safety of employees including the employer's responsibilities and plans for accident prevention in the workplace. An employer with more than 50 employees must take reasonable measures to prevent workplace accidents, and must also make efforts to protect employees from the risk of passive smoking.

G. PERSONAL INFORMATION PROTECTION

The Personal Information Protection Act requires that a Japanese business operator handling personal information must limit the use of personal information to the stated purpose and to properly manage the personal information in their possession, and forbids it from providing personal information to third parties without the consent of the individual.

H. INTELLECTUAL PROPERTY

In Japan, patents are protected by the Patent Act and the Utility Model Act* (実用新案法) of Janpan (Act No.123 of 1959). Designs are protected by the Design Act* (意匠法) of Janpan (Act No. 125 of 1959), and trademarks by the Trademark Act* (商標法) of Janpan (Act No. 127 of 1959). We must comply with these, in addition to various international treaties Japan has entered into, to maintain our intellectual property rights.

I. REGISTRATION AND TAX REPORTING

A Japanese company must, upon incorporation, register with the legal affairs bureau and continue to update its details from time to time. It must also register with the local tax agency and must annually report on corporate tax, value added tax or other taxes.