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## GAPP Issues Notice Further Restricting Foreign Participation in China's Internet Gaming Industry

### INTRODUCTION

On September 28, 2009, the PRC General Administration of Press and Publication ("GAPP"), National Copyright Administration, and National Office of Combating Pornography and Illegal Publications jointly published the *Notice Regarding the Consistent Implementation of the "Stipulations on Three Provisions" of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Internet Games and the Examination and Approval of Imported Internet Games* (Xin Chu Lian [2009] No. 13, "Notice 13"). Notice 13 restates the general principle espoused in recently promulgated regulations that foreign investment is not permitted in Internet game operating businesses in China. In addition, Notice 13 expressly prohibits foreign investors from using contractual or other control arrangements to gain control over domestic Internet game operators.

This is the first time that Chinese authorities have expressly prohibited the contractual and other control arrangements that have been used to facilitate foreign investment in certain industries in China. To date, it has been common for foreign investors to employ a series of operating, technical service, and share pledge or call option agreements to address domestic ownership requirements and other restrictions on foreign investment in these industries. Investment structures in the Internet sector have typically used such arrangements between a wholly foreign-owned domestic subsidiary and a domestic license-holding operating entity to help ensure control of the latter so that the operating entity's revenues can be consolidated for financial accounting purposes based on "variable interest entity" status with those of the foreign-owned subsidiary (the "VIE Model").

Prior to the publication of Notice 13, PRC regulators had tacitly permitted use of the VIE Model in a number of industries where foreign investment is restricted, such as advertising, tourism, and businesses requiring value-added telecommunications licenses (including Internet-related businesses, and in particular, online gaming). No Chinese laws or regulations expressly prohibited use of the VIE Model, and it has been possible to obtain reasonably qualified legal opinions from PRC law firms confirming the

legality of VIE arrangements in connection with offshore listings of companies operating domestic businesses in such restricted industries. As a result, a significant number of Chinese companies have utilized the VIE Model to structure offshore pre-IPO financings and later become listed on U.S. and Hong Kong stock exchanges. The enactment of Notice 13 on its face calls into question the feasibility of the VIE Model in the Internet gaming industry and potentially other industries in China where foreign investment is restricted. We highlight below key aspects and certain regulatory background relating to Notice 13, and consider its effect on foreign investment in China going forward.

### 1. Notice 13 Highlights

- Article I of Notice 13 defines “Internet games” as “all Internet game products provided to the public for mutual online use or for downloading through the Internet (including cable and mobile Internet).” The definition includes “without limitation” MMORPG games, Web games, casual games, downloaded stand-alone games, games with interconnecting functions (multiplayer games), web-based war game platforms, and mobile phone Internet games. “Imported” Internet games are defined as those licensed by overseas copyright owners.
- Article II states that GAPP is “solely” responsible for pre-examination and approval of Internet games as authorized by the central government and State Council, and that the provision of Internet games either online or on a downloaded basis constitutes Internet game publishing, which is subject to pre-examination and approval by GAPP. Under Article II telecom operators are further prohibited from providing Internet access for Internet games that have not been pre-approved and examined by GAPP, and GAPP is authorized to issue an order suspending operations with non-pre-approved games, as well as to conduct investigations and impose legal sanctions. In extreme cases, GAPP is authorized to revoke the relevant licenses and registrations of non-compliant Internet game operators. Interestingly, other government departments are prohibited from re-examining games that have received GAPP pre-examination and approval. It is generally understood that Article II seeks, among other things, to prevent

Internet game operators from relying on Internet publishing licenses held by third parties, a practice that was widespread during a period of time when GAPP was not granting such Internet publishing licenses. It is also understood that GAPP has recently resumed issuing such licenses, and therefore GAPP intends to enforce the requirement that Internet game operating companies obtain Internet publishing licenses directly from GAPP.

- Article III confirms that GAPP holds authority for examination and approval of imported Internet games, and that central-level GAPP approval is required before imported games can be offered to the public by Chinese game operators. Under Article III, GAPP holds similar sanctions powers with respect to imported games as those noted above.
- Article IV of Notice 13 expressly prohibits foreign investors from participating in Internet game operating businesses via wholly owned, equity joint venture or cooperative joint venture investments in China, and from controlling and participating in such businesses directly or indirectly through contractual or technical support arrangements. Article IV further prohibits the use of user registration, account administration or point-cards to enable access to Internet games or war game platforms which are de facto controlled or owned by foreign investors, as a means of permitting foreign investors from controlling or participating in online gaming operations and services.

The full Chinese text and an unofficial English translation of Notice 13 is attached for reference as an appendix to this update.

### 2. Regulatory Background

It is generally understood that Notice 13 represents GAPP’s response to the enactment of the *Regulations on the Main Functions, Internal Organization and Staffing of the PRC General Administration of Press and Publication* issued by the State Council on July 11, 2008 (“Regulation”), the corresponding interpretation thereof issued by the State Commission Office for Public Sector Reform on September 7, 2009 (“Interpretation”), and public comments thereon by Ministry of Culture (“MOC”) officials last month.

The Regulation and Interpretation were expected to dispel uncertainties as to which Chinese agency had jurisdiction for approving the establishment of Internet game operators. Before the enactment of the Regulation and Interpretation, MOC and GAPP had both claimed jurisdiction over Internet gaming operations and separately required applicants to file applications with their respective departments to operate online gaming enterprises.<sup>1</sup> These overlapping application procedures had been in existence for a number of years and were seen as redundant and burdensome by some applicant companies. The Regulation and Interpretation streamlined the process by authorizing the MOC to regulate the online gaming industry overall, while granting GAPP the authority to grant licenses for the Internet publication of online games.

Notice 13, which GAPP appears to have promulgated without involvement from MOC, continues the debate regarding jurisdiction over the Internet gaming industry by suggesting that GAPP not only has the authority to grant licenses for the Internet publication of online games, but also jurisdiction to regulate aspects of online game operations, including prohibiting the use of the VIE Model.

### 3. Implications of Notice 13

While Notice 13 appears on its face to prohibit the VIE Model frequently used for investment in the Internet gaming industry, its implementation in practice raises a number of questions:

- First, while GAPP has the authority to grant licenses for the Internet publication of online games pursuant to the Regulation and Interpretation, it appears that the Regulation and Interpretation do not give GAPP authority to regulate the operational aspects of online gaming enterprises, since MOC retains overall administrative authority thereunder. To that extent, Notice 13 may conflict with the Regulation and Interpretation. As a result, it is unclear whether GAPP holds the administrative jurisdiction to enforce the prohibition of the VIE Model that it contemplates.
- Second, Notice 13's restriction of the use of the VIE Model is unprecedented, and it bears noting that other Chinese government agencies whose participation and

assistance would be critical for effective enforcement of its prohibitions, such as the Ministry of Commerce, the National Development and Reform Commission, and the Ministry of Industry and Information Technology, did not join GAPP in issuing the Notice. The views of these bodies will be important in clarifying the scope of implementation and enforcement of Notice 13.

- Third, it appears that the promulgation of Notice 13 was, to a significant extent, a reaction to recent actions by certain foreign gaming companies in cooperation with domestic industry players. The restrictions on foreign investors (外商) are broadly written and on their face do not distinguish between strategic industry players and financial investors. As a result, it is unclear whether Notice 13 is intended to target primarily foreign game companies, or also the private equity and venture capital investors who continue to invest actively in the Internet game sector in China. In either case, however, investment or licensing arrangements that give rise to de facto control or participation in Internet game operation services by the foreign party are likely to present issues under Notice 13.

### 4. Conclusion

If applied literally and uniformly, Notice 13 would render the VIE structure used by gaming portals and many other Chinese companies that are listed overseas invalid and illegal. However, the Notice has not yet been endorsed by other PRC government authorities, most importantly MOFCOM, whose support will be necessary for meaningful implementation and enforcement. Consequently, it would be premature to write off the VIE Model at this stage. Notice 13 is one in what is likely to be a continuing series of regulatory pronouncements in this area, and further regulations/notices are needed to clarify the issues it presents. We will continue to monitor the situation on behalf of our friends and clients. ■

<sup>1</sup> MOC claimed its approval jurisdiction under the Provisional Measures on Administration of Internet Culture issued by MOC, which became effective in July 2003. GAPP claimed its approval jurisdiction under the Provisional Measures on Administration of Internet Publications issued jointly by GAPP and the Ministry of Industry and Information Technology; this came into effect in August 2002.

## APPENDIX

**English Translation of Notice 13**

September 28, 2009

**Notice Regarding the Consistent Implementation of the Stipulations on “Three Provisions” of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Internet Games and the Examination and Approval of Imported Internet Games**

Xin Chu Lian [2009] No.13

September 28, 2009

To: The Administration of Press and Publication (Copyright Bureau) and the Office of “Combating Pornography and Illegal Publications” of all provinces, autonomous regions, municipalities directly under the Central Government, the Administration of Press and Publication (Copyright Bureau) and the Office of “Combating Pornography and Illegal Publications” of Xinjiang Production and Construction Corps, the Administration of Press and Publication (Copyright Bureau) of the Propaganda Department under the General Political Department of the People’s Liberation Army

On July 11, 2008, the General Office of the State Council issued the *Notice Regarding Issuance of the Provisions on the Main Functions, Internal Bodies and Staffing of the General Administration of Press and Publication (National Copyright Administration)* (Guo Ban Fa [2008] No.90, hereinafter referred to as the Stipulations on “Three Provisions”). On September 7, 2009, the State Commission Office for Public Sector Reform issued the *Notice Regarding the Printing and Issuance of the Interpretation of the State Commission Office for Public Sector Reform on Certain Provisions of the Stipulations on “Three Provisions”*, issued by the Ministry of Culture,

*the State Administration of Radio, Film and Television and General Administration of Press and Publication, Regarding the Integrated Law Enforcement for Animation and Comics, Online Games and Cultural Market* (Zhong Yang Bian Ban Fa [2009] No.35) (hereinafter referred to as the Interpretation of “Three Provisions”), which is of vital importance for solving the long-term problems of self-created examination and approval, duplication of examination and checking in the administration of Internet games by the General Administration of Press and Publication (“GAPP”), for the performance of examination, approval and administration duties for Internet games, for strict control of contents of Internet games, guiding the development of Internet games, standardizing the administration of Internet games.

To consistently implement the decisions of the Central Government and the State Council in a serious manner, according to the *Procedures for the Administration of Internet Information Service and the Regulations on the Administration of Publication* of the State Council, the *Procedures Regarding the Strengthening of Importation Administration for Cultural Products* (Zhong Xuan Fa [2005] No.15) of the Central Propaganda Department and five other ministries and commissions, *Several Opinions Regarding Canvassing Foreign Investment into the Cultural Sector* (Wen Ban Fa [2005] No.19) of the Ministry of Culture, the State Administration of Radio, Film and Television, GAPP, National Development and Reform Commission, the Ministry of Commerce, and the Stipulations on “Three Provisions” of the State Council and the Interpretation of “Three Provisions” of the State Commission Office for Public Sector Reform, the Notice on further strengthening of the administration of pre-examination and approval of Internet games and the examination and approval of imported Internet games is hereby given as follows:

1. Internet games referred to herein shall mean all Internet game products provided to the public for mutual online use or for downloading through Internet (including cable Internet and mobile communications networks, etc.), which mainly include but not limited to: MMORPG, WebGame, leisure games, Stand-alone games downloading, games with interconnecting functions, interconnected war game platforms, mobile phone Internet games.

Imported Internet games shall mean the Internet game products licensed by overseas copyright owners.

2. Provision to the public with online mutual use or downloading of contents of Internet games through the Internet and such other operation services are Internet game publishing acts which shall be pre-examined and approved in strict compliance with the rules and regulations of the State. GAPP is the governmental department solely responsible for the pre-examination and approval of Internet games as authorized by the Central Government and the State Council.

Without the pre-examination and approval of GAPP and obtaining of the Internet publishing license with scope of operation covering Internet games, any organization or individual shall be prohibited from engaging in online game operation services. Otherwise, the departments for the administration of press and publication will ban the same in accordance with the law and at the same time, inform the department for the administration of telecommunications to cancel the corresponding value-added telecommunication operation service license of such organization or individual and inform the administrative department for industry and commerce to change or cancel the registration in accordance with the law.

All Internet games not pre-examined and approved by GAPP shall not be uploaded and the telecommunication operators shall not provide Internet access services for such Internet games. The Internet games which have been pre-examined and approved by GAPP may be used on the Internet, and any department shall not re-examine such games which shall be administered by cultural, telecommunication and such other departments in strict accordance with the contents of pre-examination and approval by GAPP.

In the event no pre-examination and approval by GAPP has been obtained for Internet games operation or contents of Internet games have changed without examination and approval of GAPP, GAPP shall inform the relevant local department for the administration of press and publication to issue an order for suspension of such operation services, and conduct investigation and impose sanction in accordance with the law.

3. GAPP shall be responsible for the examination and approval of imported Internet games. Authorizations from the copyright owners shall be obtained in advance in accordance with the law for all imported Internet games operated in China, and the formalities for certification of copyrights shall be completed. Upon obtaining of the Approval Reply for Registration of Copyright Contract issued by the department for the administration of copyrights, the operating entity shall make an application to the bureau of press and publication at the provincial level where such entity is located, and the same will be filed with GAPP for examination and approval upon examination by and with the consent of the bureau of press and publication at the provincial level.

In the event imported Internet games operation services in China have not been examined and approved by GAPP, or overseas Internet games operations are marketed in China without examination and approval of GAPP, GAPP shall inform the relevant local department for the administration of press and publication to ban the same and suspend the relevant operation, and inform the department for the administration of telecommunications to cancel the relevant Internet access service and close down the related websites.

Engaging in the operation of imported Internet games without legal authorization by overseas copyright owners shall be deemed as news infringement and piracy, and the National Copyright Administration shall, in conjunction with the administrative departments for telecommunications, industry and commerce and such other departments, establish a case for investigation and sanction according to the *Copyright Law of the PRC*, and the *Regulations on the Protection of the Right of Communication through Information Networks* of the State Council and such other laws and regulations.

Suspected criminal cases shall be transferred to the authority of public security for investigating into criminal liabilities in accordance with the law.

4. Investments by foreign investors in Internet game operation services in China by means of wholly-foreign owned, equity joint venture, or cooperative joint venture enterprises shall be prohibited. Foreign investors shall not be de facto controllers of, or engage in the Internet game operation services of domestic enterprises through the establishment of other equity joint venture enterprises, execution of relevant agreements or provision of technology support and such other indirect means, and shall not control or participate in Internet game operation services in disguise by direct introduction of user registration, account administration, point-card consumption into interconnected game networks, war game platforms with foreign investors as the de facto controller or owner of such platform or by such other means. In the event of a violation of these provisions, GAPP shall, in conjunction with the relevant departments of the State, investigate and handle the same in accordance with the law. In serious cases, the relevant license and registrations shall be cancelled.
5. When an operating entity for Internet games subject to pre-examination or examination and approval for importation by GAPP is changed, the operating entity shall be required to re-initiate the same procedures for pre-examination and approval or for examination and approval for importation. From the date the operating entity changes until the date the new approvals are obtained, all operational services for the relevant Internet games shall be suspended. Otherwise, operations during such time shall be deemed as illegal web publishing.
6. Where new versions, information shall be supplemented or new contents shall be updated for Internet games with the pre-examination or examination and approval for importation by GAPP, the operation entity shall undertake the same procedures for the pre-examination or examination and approval for importation. In case of unauthorized operation of new versions, new information or updating of new contents without the pre-examination and approval or examination and approval for importation of GAPP, GAPP shall cancel the original documents of pre-examination and approval

or examination and approval for importation and inform the relevant local department for the administration of press and publication to issue an order in accordance with the law to suspend operation services, and investigate into the case and impose punishment as a case of illegal web publishing. Where unauthorized operation of new versions, new information or updating of new contents and the supplemented or updated contents are in violation of laws and regulations, severe punishment shall be imposed, and the department for the administration of telecommunications shall be informed to cancel the relevant Internet access service and close down the related websites.

Upon the receipt of this Notice, the working departments of news and press, patents, “Combating Pornography and Illegal Publications” of all localities shall immediately forward this Notice to all relevant local administrative departments and enterprises, and centralize the efforts to jointly organize an overall clearance of the examination, approval and operation services of Internet games in this October. Violations of laws and regulations shall be investigated into and handled in a serious manner in accordance with the law.

#### **General Administration of Press and Publication**

#### **National Copyright Administration**

#### **National Office of “Combating Pornography and Illegal Publications” ■**

## 附录

## 《“三定”规定》

2009年9月28日

### 关于贯彻落实国务院《“三定”规定》和中央编办有关解释，进一步加强网络游戏前置审批和进口网络游戏审批管理的通知

新出联[2009]13号

2009年9月28日

各省、自治区、直辖市新闻出版局（版权局）及“扫黄打非”工作领导小组办公室，新疆生产建设兵团新闻出版局（版权局）及“扫黄打非”工作领导小组办公室，解放军总政治部宣传部新闻出版局（版权局）：

2008年7月11日，国务院办公厅发出《关于引发国家新闻出版总署（国家版权局）主要职责内设机构和人员编制规定的通知》（国办发[2008]90号，以下简称《“三定”规定》），2009年9月7日，中央编办发出《关于印发〈中央编办对文化部、广电总局、新闻出版总署《“三定”规定》中有关动漫、网络游戏和文化市场综合执法的部分条文的解释〉的通知》（中央编办发[2009]35号）（以下简称《“三定”解释》），对于解决长期以来在网络游戏管理中存在的自设审批、重复审查的问题，对于新闻出版总署依法履行对网络游戏的审批管理职责，对于严把网络游戏内容关、引导网络游戏开发、规范网络游戏管理具有重要意义。

为认真贯彻落实中央和国务院的决定，依据国务院《互联网信息服务管理办法》和《出版管理条例》，中宣部等六部委《关于加强文化产品进口管理的办法》（中宣发[2005]15号），文化部、国家广电总局、新闻出版总署、国家发展和改革委员会、商务部《关于文化领域引进外资的若干意见》（文办发[2005]19号），以及国务院《“三定”规定》和中央编办《“三定”解释》，现就进一步加强网络游戏前置审批和进口网络游

戏审批管理通知如下：

一、本《通知》所称网络游戏是指所有通过互联网（包括有线互联网和移动通讯网络等）供公众在线交互使用或提供下载的互联网游戏作品。主要包括但不限于：大型角色扮演类网络游戏（MMORPG）、网页游戏（WebGame）、休闲游戏、单机游戏的网上下下载、具有联网功能的游戏、联网的对战游戏平台、手机网络游戏。

进口网络游戏是指经境外著作权人授权的互联网游戏作品。

二、将网络游戏内容通过互联网向公众提供在线交互使用或下载等运营服务是网络游戏出版行为，必须严格按照国家法规履行前置审批。新闻出版总署是中央和国务院授权的唯一负责网络游戏前置审批的政府部门。

未经新闻出版总署前置审批并获得具有网络游戏经营范围的互联网出版许可证，任何机构和个人不得从事网络游戏运营服务。否则新闻出版管理部门将依法予以取缔，同时通知电信管理部门取消其相应增值电信业务经营许可证，通知工商行政管理部门依法变更登记或注销登记。

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未经新闻出版总署前置审批上网运营或审批后擅自改变内容的网络游戏，新闻出版总署将通知有关地方新闻出版管理部门责令其停止运营服务，并依法予以查处。

三、新闻出版总署负责进口网络游戏审批。所有在中国境内运营的进口网络游戏必须事先依

法取得著作权人的授权，并办理著作权认证手续，在取得著作权行政管理部门出具的《著作权合同登记批复》后，由运营单位向所在地省级新闻出版局申报，经省级新闻出版局审核同意后报新闻出版总署审批。

对未经新闻出版总署审批，擅自在中国境内提供进口网络游戏运营服务，或为境外网络游戏在中国境内提供运营推广服务的，新闻出版总署将通知有关地方新闻出版管理部门依法予以取缔，停止其运营，并通知电信管理部门取消其互联网接入服务，关闭相关网站。

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