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# Russia Legal Update

## Arseny Seidov



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Mr. Seidov co-chairs the tax subgroup of the US-Russia Bilateral Presidential Commission's Innovation Working Group, leading the work on drafting laws to remove obstacles and create incentives for businesses that promote R&D and innovation in Russia. For many years he has been a frequent speaker at key tax conferences and seminars organized by the American Chamber of Commerce and the Association of European Businesses. He has authored over 35 professional publications and, since 2007, has been a visiting professor of tax law at the Moscow State Institute of International Relations (MGIMO University).

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# Personal data laws - changing interpretations and enforcement

As of September 1, 2015 the personal data of Russian citizens must be initially recorded, stored and updated on databases located in the Russian territory. Initially, Roskomnadzor, the Russian agency with regulatory authority over personal data (“RKN”), interpreted personal data as information relating to unambiguously identified individuals (e.g. information linked to passport details, full name and home address etc.). Thus, the newly introduced localization requirements did not significantly affect the video game industry, which only collected minimum data on Russian gamers. However, this started to change in mid-2016, when RKN started to opine, inter alia, that personal information collected through web analytics tools (such as IP addresses and other technical data) also qualified as personal data.

In 2016, RKN started the actual blocking of reputable multinational services on the grounds of violation of domestic personal data laws. It also dramatically extended its interpretation of personal data, which may require game companies to reconsider their personal data compliance measures in Russia. In particular, the agency sued LinkedIn, alleging violations of Russian personal data laws and, specifically, of the localization requirements. The lawsuit ultimately resulted in the blocking of [www.linkedin.com](http://www.linkedin.com) and LinkedIn’s mobile apps in Russia.<sup>1</sup>

The changing approach towards technical user data, together with RKN’s approach of blocking websites, may become a major issue for the video game industry in the long term.

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<sup>1</sup>One of the arguments made by RKN was that LinkedIn collects personal data without consent, particularly, by collecting information about the IP and MAC addresses of all website visitors, not just those who consented to its privacy policy during registration. The Russian courts neither supported nor expressly rejected these arguments, and granted the lawsuit on different grounds. However, the mere fact that RKN raised these arguments in court and subsequently re-affirmed its position in public speeches clearly demonstrates an important change in its interpretation of personal data, which should definitely be taken into account by the industry.

## **Restricted content, indecenty and child protection**

Games can contain content that is classified as either prohibited or restricted under Russian law. Prohibited content is not allowed to be distributed in Russia. Its inclusion in online games may lead to their blocking by the competent authorities in Russia, unless said content is deleted from the game. The distribution of restricted content without an appropriate age rating is generally prohibited. Online games may be blocked unless such content is deleted from the game or an age rating is assigned.

If a game contains depictions of homosexual relations, it is also recommended that the age of the person buying the game be verified (e.g., by publishing an age confirmation notice in relation to the online game). Public events relating to games that contain restricted content, and posters promoting such public events, are also subject to special age restriction rules.

## **Consumer protection and related enforcement practices**

When existing or prospective Russian players are targeted, Russian consumer protection laws may apply even if the laws governing the game provide consumers with less protection.

Consumers may submit their claims with local state courts, and such courts normally accept and review these claims on the merits, irrespective of dispute resolution clauses in the terms & conditions and/or license agreement for the game. Furthermore, consumers may file a direct claim against the game's seller and manufacturer. Potential claims are not limited to common compensation of damages (if any), but may also include replacement of a defective game, rectification, refund and compensation for moral harm.

The video game industry nowadays does not have a significant flow of consumer claims. Typically, the compensation amounts awarded to consumers are fairly low (roughly the amount paid for the product and related services). Many claims are settled amicably. At the same time, the current trend in consumer protection enforcement practice is related to increases in compensation amounts and to the engagement of various law-enforcement authorities, especially for high-end and expensive products.

The amount of practical risk increases dramatically if a game is played with special equipment sold together with the game or separately. Irrespective of the limitations which may be listed in the sales contract or applicable terms of use, such equipment may be subject to mandatory Russian technical regulations, including health & safety, disclosure, and marking requirements.

## **Cybersports regulation and esports benefits**

ESports were recognized as official sports in Russia during the summer of 2016. However, the recognition of eSports is merely the first step in their incorporation into the Russian system of ‘traditional’ sports.<sup>2</sup> Official rules and detailed sports regulations will also need to be adopted.

As a result of this recognition, general rules for running sports events may also apply to eSports events if they are included in federal, regional or municipal calendar plans of official sporting events. The inclusion of an eSports event into the relevant calendar plan may have its benefits, e.g. budgetary financing at the federal, regional or municipal level, allowance for so-called perimeter alcohol advertising during official sporting events (only until January 1, 2019). If an eSports event is not included into any of the above calendar plans, the relevant rules do not apply to such event.

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<sup>2</sup>This step must be followed by accreditation of an official all-Russian eSports federation by the Russian Ministry of Sports (the completion of this procedure is scheduled for spring 2017).

The principal question is whether professional eSports really need such recognition. Full incorporation into the state system of sports in Russia will most likely lead to a situation where major eSports events would be subject to detailed state administrative rules (e.g., construction requirements, safety and security rules, etc.), which could be highly unattractive from a legal and business point of view. However, having a state system of eSports in Russia with direct assistance from the all-Russian eSports federation may help to expand the popularity of a sport among amateurs, enlarge the target audience, and attract new sponsorship contracts into the industry.

## Taxation of gaming revenues

There are no special tax rules relevant to the video game industry as such. Depending on where the publisher is located and how the relationships with consumers are structured, the relevant fees may or may not be subject to Russian 20% profits tax and 18% VAT.<sup>3</sup>

As of January 1, 2017, Russia has introduced a VAT regime on electronically supplied services (“ESS”). Whether the publisher receives licensing or service revenue from Russian sources, it may qualify as ESS for domestic VAT purposes. Under the new regime, foreign suppliers directly collecting such revenue from Russian individuals are required to register as taxpayers in Russia and pay the VAT themselves through a special e-office opened with the Russian tax authorities.

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<sup>3</sup>In a cross-border context, license fees are generally subject to a 20% withholding profits tax (which can be reduced to 0% under many double tax treaties with Russia). However, if the licensor is located outside of Russia with no taxable presence in the country, and license fees are collected directly from individuals, there is no enforceable mechanism to withhold the tax, since regular consumers do not act as tax agents. If there are Russia-based corporate intermediaries or agents in the cash flow chain, e.g. payment aggregators (and provided they are not regular payment processors performing the technical function of card acquiring), then such businesses may be potentially required to act as such tax agents, and to verify whether the publisher is located in a treaty jurisdiction and eligible for double tax treaty benefits as the beneficial owner of a Russian source licensing income.

If relationships with gamers are structured, for example, as a free license with paid services for additional in-game features, then such service fees are not subject to withholding tax under the domestic tax rules. There would be no need to rely on a double tax treaty, if one exists.

At the same time, starting from 2008, under the Russian Tax Code software use licenses are exempt from VAT. In 2015 the Supreme Court ruled in its landmark case against Mail.Ru Games, the largest domestic online games company, that paid services for organizing in-game time where all the elements of the game have already been provided to the gamer under the free end-user license may not enjoy the VAT exemption.

At the beginning of 2017, the Federal Tax Service issued a guidance letter of a non-binding nature about additional in-game functionality and application of the VAT exemption to in-game currency. The FTS letter seems to support the idea that certain additional “sleeping” game functionality (described as “deactivated data and commands”), which only becomes operational subject to additional payment, can form the subject matter of a separate software license agreement and, thus, may be exempt from Russian VAT. However, the letter is silent on the actual scenarios in which the FTS would consider that certain functionality constitutes such “deactivated data and commands”. Whether a particular publisher may be eligible, in full or in part, to this VAT exemption needs to be carefully explored, keeping in mind the underlying facts specific to the game, its IT architecture, and its licensing terms.

## **Monetization and payment infrastructure, in-game currency and electronic cash registers**

Gamers may place cash on their game accounts via payment terminals operated by different categories of payment agents. According to the Russian anti-money laundering laws, payment agents and other organizations must identify their clients if the latter make a cash payment in favor of a foreign entity or any payment in excess of RUB 15,000 (app. \$260).<sup>4</sup>

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<sup>4</sup>In practice, the identification process is unreasonably complex and makes smooth cash monetization directly by foreign publishers almost impossible. However, there are ways to structure relationships with consumers in such a way that this restriction can be legitimately circumvented.

E-commerce payment processing companies doing business in Russia may be subject to special regulations concerning the national payment system and payment agents. Such regulations might require the publisher to operate special accounts with Russian banks, and to perform other activities. Therefore, it is advisable that publishers perform at least some basic due diligence of their Russian intermediaries providing payment collection and processing services.

Payment structures involving in-game currency, gift cards and vouchers are restricted to those issued by game publishers, Russian banks or other licensed credit organizations in Russia. If they are issued or operated by a third party, or used outside of the game to pay for products (e.g. game-related merchandise) and/or services, then these payment structures could be in breach of financial regulations enforced by the Russian Central Bank.<sup>5</sup>

Starting from July 2017, all Russian game publishers collecting payments with the use of e-commerce payment systems must use electronic cash registers for processing payments online. Such cash registers allow the issuing of electronic receipts to consumers, transmitting all payment data to special processing centers accessed by the Russian tax authorities. All new electronic cash registers must be certified in Russia and registered with the Russian tax authorities.

## **Branded merchandize market and co-branding programs**

As game publishers explore alternative revenue streams, branded merchandise and co-branding of services are becoming more common for the Russian video game market. These include co-branded payment card programs with Russian banks, special cash back and discount programs, branded promotional life insurance offers, and even branded soft drinks and promotional burgers.

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<sup>5</sup> While it is unlikely that this position would be enforced against companies located outside of Russia, it should be taken into account for the activities of Russian distributors, since local payment recipients operating the said in-game currency may be held liable for performing an activity for which they do not have proper authorization.

Launching both licensed merchandise and co-branding programs has become much easier in the last couple of years, thanks to the recent trademark law reform and relatively flexible Russian trademark and copyright laws. At the same time, Russian legislation retains several challenges that should be taken into account.

Although trademark license agreements now become effective upon execution, the relevant trademark licenses still need to be registered with the Russian patent and trademark office (“**Rospatent**”). Legally structuring such license arrangements may also become an issue for game publishers that do not have trademark protection in the relevant classes of goods or services, or whose trademark applications have not matured to registration yet. Mandatory provisions of Russian trademark and copyright law should also be taken into account, in particular, to avoid license validity issues, to mitigate the trademark licensor’s joint and several liability for licensed products, to have the trademark smoothly recorded with Rospatent, etc.

Game publishers who are considering such options may also wish to extend their Russian trademark coverage in advance, as it takes roughly a year to register a trademark in Russia. Such protective trademark registrations would also be helpful for potential enforcement, as both counterfeit merchandise and the practice of ‘free-riding’ on the reputation of third-party brands appear to be on the rise.

## **IP enforcement against counterfeit merchandise and unauthorized mods**

As game franchises attract new fans, counterfeit merchandise tends to flood local markets. The three most rapidly developing offerings are (i) low-quality imported goods, (ii) online printing platforms that produce merchandise on demand, often using a library of user-generated prints and designs, and (iii) online stores operated by fan communities. These are actively promoted via search engine ads, and social media may supplement or even replace traditional online storefronts for such products.

Another dark and increasingly popular area in Russia is unauthorized mods and cheats. They are frequently distributed on a paid basis in a similar manner via social media, third party platforms, marketplaces, etc.

At least some infringers are potentially friendly and can be persuaded by a plain cease and desist letter. If an infringer cannot be persuaded this way, Russia has a broad set of remedies, including many basic remedies available in the EU: notices of infringement to operators of marketplaces and hosting providers; UDRP proceedings with respect to new generic top-level domains <sup>6</sup>; suspension of new generic top-level domains by registrars or registries in certain cases; etc.

In comparison to the EU, there are a number of tools which are specific to Russia. Despite recent amendments to legislation on attorney activities, which have made the procedure less binding for service providers, most local registrars and hosting providers respond to requests from licensed attorneys to disclose an infringer's identity (i.e. name and residential address). The Court for Intellectual Property Rights and a judge of the Supreme Court have also recently confirmed that in order to benefit from safe harbor provisions, hosting providers need to cooperate with rights holders in identifying the infringers upon their request. Such information proves helpful when seeking to persuade infringers or when taking subsequent enforcement steps.

Another important tool is a court injunction issued by the Moscow City Court in an expedited manner, which may subsequently lead to the permanent blocking of an infringing website. <sup>7</sup> One AAA game developer has recently used this tool to permanently block an unauthorized online store that was selling game license codes, but it may also be used against various forums containing links, torrent files and file-sharing platforms.

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<sup>6</sup> However, Uniform Domain-Name Dispute-Resolution Policy is not available for country code .RU and Cyrillic .RF domain names.

<sup>7</sup> There also is a pending bill aimed at facilitating the blocking of derivative versions of permanently blocked websites and delisting them from search engines.

# In-game promotions and digital advertising

Generally, commercial promotions, games of skill, games of chance and other promotions operated by business (non-state) entities do not require special notification or registration with the Russian authorities. Still, if such promotions target Russian consumers, then specific disclosure obligations apply. For example, promotions requiring the purchase of a product must contain a disclosure in Russian including the full name of the entity arranging the promotion, and a reference to the promotion's terms & conditions, prices, distribution period, etc.

Importantly, if Russian consumers are targeted, advertisers and/or advertising distributors must follow the following principles when distributing their adverts: (a) prior consent must be obtained from the consumer before showing an advert via electronic communication channels (including the internet); and (b) consumer must be allowed to opt out of receiving the advertising.

In accordance with Russian advertising law and the enforcement practice of Russian courts, consent to receive advertising must be specific and, ideally, isolated from the main terms & conditions of the game. The right to opt-out cannot be waived.

**March 2017**



# Overview on German law

## Tobias Schelinski



Tobias Schelinski is a member of Taylor Wessing's Practice Area Technology, Media and Telecoms. He specializes in games-law, software license and distribution law, data protection law and e- and m-commerce law, and advises on complex IT-projects as well as on cross-border contracts and transactions.

Tobias studied law at the University of Hamburg focusing on „Information and Communication law“, and as part of his studies he spent several months with a law firm in South Africa. After successfully passing his first state examination, he finished his doctorate dissertation entitled “Government Supervision of Cross-Border Online Services“.

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Tobias is qualified as a specialist solicitor for information technology law and is also a lecturer in the Masters course for Games law Hamburg University of Applied Sciences. He is co-author of the Munich Lawyers' Handbook for IT Law and has also written a number of other publications.

# | What's new in Germany?

In 2016, several German courts dealt with interesting questions regarding video games. For example, they decided on the legal treatment of bots, the sale of product keys, and the question whether, and under what conditions the purchase of virtual currency in a game can be withdrawn.

Furthermore, a German court reached the little surprising conclusion that World of Warcraft is not only played by children. Finally, the German Copyright Act was amended which has some impact on the games industry.

## | No Bots for Azeroth!

### **What happened?**

Blizzard Entertainment brought two case actions against the distribution of bot programs for World of Warcraft against Bossland. Bossland is a German company that develops and distributes specific bots for World of Warcraft and Diablo III.

The first landmark decision of the German Federal Court of Justice (“BGH”) deals with the infringement of the German Act on Copyright and Related Rights (“Copyright Act”) by developing bots whereas the second decision deals with a violation of the Act Against Unfair Competition and trademark violations.

### **Developing Bots is a Copyright Infringement!**

Bossland was enjoined to stop developing and offering bots for World of Warcraft and Diablo III and was ordered to pay damage compensation to Blizzard Entertainment.

Blizzard argued that Bossland infringed the End User License Agreement (EULA) of both games by reproducing the client-software of the respective video game during the bot development process. The relevant passages of the EULA state that the client-software of World of Warcraft and Diablo III are only for personal and non-commercial use and the use of cheats, mods or hacks or any other software created by a third party is prohibited.

The BGH found firstly that the client-software is protected under the Copyright Act and Bossland reproduced the software when developing the bots and secondly that the reproduction of the software was not allowed under the EULA. The court held that the applicable terms and conditions in the EULA are valid and argued that Bossland's practice exceeded the permitted private use of World of Warcraft and Diablo III.

## **Distribution of Bots is unfair (Competition)!**

The BGH decided that the distribution of bots violates the German Act Against Unfair Competition.

The main issue in this decision was the distribution of two Bossland bots called "Honorbuddy" and "Gatherbuddy". Blizzard Entertainment argued that the distribution of bots is not lawful under the German Act Against Unfair Competition. Further, Blizzard argued that an advertisement with "WOW Bot" and "World of Warcraft Bot" constitutes a trademark violation.

The court stated that the distribution of bots is likely to result in economic loss for Blizzard Entertainment since rule-consistent players are demotivated by other players using bots and will therefore stop playing "World of Warcraft". Furthermore, the distribution of bots affects the whole product "World of Warcraft" by violating the rules of World of Warcraft which shall protect the equality of opportunities among the players.

**The development or distribution of bots violates copyrights and the German Act Against Unfair Competition. Proceedings against a developer or distributor of bots are very often successful in Germany!**

# Waiving the Right of Withdrawal by purchasing Virtual Currency

The Federation of German Consumer Organizations (“vzvb”) brought an action against Gameforge, the developer of “NosTale”. The vzvb complained that Gameforge asked its players to waive their mandatory right of withdrawal during the buying process of “NosDollars”, a virtual currency in “NosTale”, by clicking the “Buy now”-Button which says “right of withdrawal expires”. The right of withdrawal was implemented in the course of the transposition of the European Consumer Sales Directive into German Law and means that consumers are allowed to unilaterally withdraw from a contract concluded via internet without any reason.

The right of withdrawal can be waived in cases of the purchase of “digital goods” in the meaning of the German Civil Code. vzvb argued that “NosDollars” are no digital goods, and as a consequence the right of withdrawal cannot be waived by clicking the “Buy now”-Button.

By rejecting the opinion of the vzvb, the court held that virtual currencies are digital content in the meaning of the German Civil Code. The purchase of “NosDollars” not only constitutes an obligation between buyer and seller but rather is a purchase of special game content, which is the value of every “NosDollar” as laid down in the game. However, the court determined that Gameforge’s withdrawal waiver during the purchase process in Gameforge’s online shop is not in accordance with the law. According to the court, the phrase “right of withdrawal expires” as used by Gameforge shows that a right first has to be established before it can “expire”. In general, the right of withdrawal rises from the purchase contract. Waiving the right of withdrawal and agreeing to purchase the “NosDollars” cannot be conducted by one single click. According to the court, the waiving of the right of withdrawal can only take place in a separate, second step after the purchase.

What can be taken from this decision of the District Court in Karlsruhe by now is that currencies are digital content. Gameforge filed an appeal to the Higher Regional Court.

**Good news: Finally, there is a court decision regarding the waiver of right of withdrawal with regard to virtual currency.**

**Bad news: The courts' requirements are unfavorable for players and the games industry.**

## | Do only Children play Games?

According to the German Act Against Unfair Competition, a direct exhortation to children to purchase goods or services marketed is not lawful.

vzbv complained that Blizzard specifically asked children to buy the “Armored Bloodwing” in World of Warcraft with the advertising slogan “BUY IT NOW!” and argued that a “colorful fantasy game” like World of Warcraft is predominantly played by children.

However, the Higher Regional Court in Berlin rejected this opinion. The mere fact that World of Warcraft plays in a fantasy world with fantasy creatures does not entail that such game is predominantly played by children. As a result, the advertisement does not specifically address children and is lawful under the German Act Against Unfair Competition.

**Surprising result: Also adults play fantasy games! As a consequence, direct exhortations in games can be lawful.**

## | (Re)sale of Product Keys: Only lawful under certain Conditions!

According to the UsedSoft case law, it is generally lawful to resell used software licenses. However, certain criteria have to be met.

A recent decision of the Higher Regional Court in Hamburg states that the reseller has to provide potential customers with all information necessary to check if the UsedSoft criteria are met. For example, information about which kind of license was originally granted to the first purchaser and what kind of legal relationship exists between the first purchaser and the reseller.

Apart from that, the reseller has to inform the buyer about his right to use the program in accordance with its intended purpose (e.g. if the buyer is allowed to get the latest updates etc.).

Otherwise the reseller violates German Act Against Unfair Competition and can be subject to claims for damages and injunctive relief.

**This decision also applies to re(seller) of game-keys. A (re)seller is obligated to inform buyers about details of the license. Otherwise, the (re)seller violates the German Act Against Unfair Competition.**

## Legal Amendment of the Copyright Act in 2016

The German legislator amended the Copyright Act in December 2016.

Creators of works that grant usage rights with respect to this work have more rights now. They can ask the party that uses the work for information regarding the extent of usage, gained profit and other benefits resulting from exploitation of the creators work once a year. This right is excluded if the relevant work is software and/or if the right deemed to be disproportionate, e.g. if the owner's work does not have substantial influence on a licensee's creation.

A so-called secondary usage right provides that a creator who grants a party an exclusive right of exploitation against remuneration is able to resume exploitation after a minimum of ten years. The first right holder retains no longer exclusive but normal exploitation rights. However, this provision does not apply to software and cinematographic works.

**The amendment of the Copyright Act does mostly not affect video games.  
How-ever, it can influence merchandise and marketing in the games industry.**

**March 2017**



# How to Beat the Cheats

**Marc Mayer**



Marc Mayer is a partner in the Intellectual Property Practice Group at Mitchell Silberberg & Knupp LLP. His work is at the forefront of intellectual property and copyright law, especially as it relates to new and emerging technologies.

He concentrates his practice in the areas of copyright, trademark, trade secret, and right of publicity disputes in the entertainment and technology industries. Ranked among the nation's leading intellectual property litigators, Mr. Mayer has been an indispensable member of lead counsel teams in many of the most important copyright and trademark cases to have been litigated in recent years.

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Imagine a poker tournament in which some players were allowed see their opponents' cards. Or a golf tournament in which the fairways magically widened for a select few players. Fantastical though they are, these scenarios approximate the real-life dilemma faced by video game publishers. Their businesses are being threatened by software that gives players artificial advantages such as flawless aim, invisibility, and the ability to play via "bots" that advance players through a game without any effort. The stakes are high all around. Cheat software imperils not just the short-term profits that video game publishers reap from their creations, but also the reputations of game publishers and the long-term viability of their products.

According to a Nielson survey, among console and computer gamers over the age of 13 in the United States, 16% admitted to cheating in a video game. More than a third had stopped playing a game due to cheating. Moreover, the market for cheating software shows no signs of slowing. In fact, just days after Blizzard's hotly anticipated game Overwatch hit the market in May 2016, a company released software that enabled players to see through walls and fire weapons that never miss. (The software was quickly detected by Blizzard, resulting in hundreds of account bans.) Meanwhile, companies that develop and sell cheating software can amass huge sums from the sale of their software products. Thus, now more than ever, game publishers need a set of effective tools and strategies.

## **| What is the problem ?**

"Cheats," "hacks," "exploits," and "bots" are loose terms that encompass a variety of software products that exploit an online service to give an unfair advantage to one user over another. Among the most prevalent form of video game exploitation software are bots. Bots are software programs that automate player actions. Bots often are used in "massively multiplayer" games such as World of Warcraft, where they can be programmed to perform time-consuming or repetitive tasks to accumulate gold or experience (a practice known as "farming"). Since bots never tire, grow bored, or face competing time commitments, they can accumulate in-game items, experience, and currency at an unfair pace. In competitive multiplayer games, bots are able to react to events with inhuman speed and accuracy or to make decisions based on calculations that are beyond normal human ability (for instance, by counting cards in games such as Hearthstone).

In addition to video game bots, those seeking to exploit social networks or other websites have created software such as “spam bots,” which populate message boards with advertisements; “scraper bots,” which crawl websites and gather information; “auction bots,” which manipulate auction pricing; or “chat bots,” which impersonate humans to trick people into revealing personal information.

A second category of cheats are **artificial enhancements** or **exploits**, which manipulate an online game to give a player superhuman abilities or skills. These cheats come in all shapes and sizes. “Aimbots” assist players in first-person shooter games by causing a weapon to automatically aim at an opponent. “Wall hacks” allow players to see enemies through walls or other obstacles. “Map hacks” for strategy games such as Starcraft II lift the “fog of war” to reveal otherwise hidden information about enemy unit placement or strategy. Other popular exploits give players unlimited ammunition, extra currency, increased health, or rapid reload speed. Just recently, hackers created an exploit for the game Grand Theft Auto V that enabled players to drain virtual cash from the accounts of others without their knowledge – a virtual grand theft.

Regardless of the motive, the harm caused by cheats to other players and to the game publisher is real. Players who are frustrated or discouraged by cheaters may quit playing the game and spread negative word of mouth, deterring others from playing. The use of bots and cheats also may deprive the publisher of microtransaction revenue. Moreover, word that a game is plagued with cheaters or bidders will harm the publisher’s reputation, and it may be difficult or impossible to recover from that reputational harm.

## **| Fighting cheats and bots in court**

For most game publishers, the first line of defense against bots and cheats is a combination of technical and contractual measures.

On the **technical** side, many game publishers incorporate into their games some form of “anti-bot” or “anti-cheat” technology, such as Blizzard’s Warden, the Valve Anti-Cheat system (“VAC”), PunkBuster, or HackShield. These technologies can be effective at detecting hacks and cheats and preventing players from accessing a game while running an unauthorized piece of software. On the **contractual** side, multiplayer games usually require the player to assent to an End User License Agreement (EULA), pursuant to which they agree not to make or use cheats, bots, hacks, or other unauthorized software. Most players recognize that when they assent to the EULA they are promising not to cheat and can have their access to the game revoked if they do so. Courts have found that EULAs are enforceable contracts.

However, these technical and contractual measures alone are often insufficient to deter cheaters. They also, for the most part, will not stop individuals or companies from attempting to make money from the sale of cheating software. Such people or entities have the financial incentive and technical know-how to create software that can bypass, evade, or disable a game publisher’s anti-cheat technology. Cheat sellers also maintain message boards that warn their customers when their software has become detected by the game publisher and when a new, updated, undetectable version of the software is available. The result is that publishers and cheat sellers often are caught in an endless “arms race,” with cheat sellers updating and improving their software almost as soon as it is detected by the publisher. Those making money from selling cheats, as well as dedicated cheaters, care little about their contractual obligations. Many cheaters know that cheating carries some risk, and thus they may cheat or bot on “throw-away” accounts. Perhaps most troubling, cheat sellers and cheaters often will work together to devise strategies for avoiding detection by the game publisher or for regaining access to an account that has been banned or suspended.

In order to be truly effective, the contractual and technical measures developed by the game publisher must be supplemented by use of the court system. Filing lawsuits serves several purposes. In addition to obtaining monetary judgments, game publishers can obtain various forms of non-monetary relief, including orders enjoining the cheat seller from exploiting its product, seizing the seller’s assets, and cutting off access to mainstream payment providers such as PayPal. Litigation also sends a message to cheaters and hackers that such conduct will not be tolerated, and that the consequences go beyond simply an account ban or suspension.

Perhaps most importantly, litigation sends a message to the legitimate-player community that the company takes such conduct seriously and will spend the time and resources to protect the integrity of its online experience.

While litigation against bots and cheats was once fairly rare, a number of such lawsuits have been filed in the United States over the past several years. At Mitchell Silberberg & Knupp, we have filed more than a dozen such lawsuits in the past few years on behalf of companies such as Blizzard, Riot, and Nexon. We have sued the makers and sellers of bots, private servers, and other cheats. Recently, a number of companies other than game publishers, including Twitch, LinkedIn, Ticketmaster, and others, also have filed lawsuits. In some of these cases, the plaintiffs have recognized that bots not only are annoying to their customers, but harm their computer networks and can result in network slow-down or denial of service.

Lawsuits have been almost uniformly successful. Just this year, a U.S. court awarded more than \$8.5 million against Bossland GmbH, the maker of the popular World of Warcraft bot “Honorbuddy,” and \$10 million against the makers of the League of Legends cheating software “LeagueSharp.” Over the past few years, court actions have resulted in the closure of more than a dozen bots and cheats, including cheats for Combat Arms, Runescape, World of Warcraft, Starcraft II, Maple Story, and others.

## **I Legal theories used to fight bots**

For better or for worse, the proliferation of anti-cheat and anti-bot lawsuits has not resulted in a substantial development of United States law. This is because many cases are resolved through default judgments or out-of-court settlements. Also, in some instances courts have declined to issue published decisions. Thus, for example, in two cases filed by Nexon against a MapleStory private server (Nexon America, Inc. v. Hein) and a Combat Arms exploit (Nexon America, Inc. v. GameAnarchy LLC), judgments were entered in favor of the plaintiff without a detailed written opinion.

Nevertheless, most anti-cheat lawsuits rely on a fairly consistent set of legal theories. These legal theories have found support in the key reported decisions, including *MDY v. Blizzard Entertainment, Inc.*, 629 F. 3d 928 (9th Cir. 2010) (the Glider case) and *Blizzard Entertainment, Inc. v. Ceiling Fan Software LLC*, 28 F.Supp.3d 1006 (2013) (the Pocket Gnome case). These legal theories include: (1) violation of the “anti-circumvention” provisions of the Digital Millennium Copyright Act (“DMCA”), (2) intentional interference with contractual relations, (3) copyright infringement, and (4) violation of the Computer Fraud and Abuse Act.

**Violation of the Digital Millennium Copyright Act:** Section 1201 of the DMCA prohibits individuals from trafficking in devices that circumvent “technological measures” that (1) control access to a copyrighted work (i.e., they pick a digital lock), or (2) protect “an exclusive right of a copyright owner” (i.e., they defeat copy protection).

Under the Glider case and others, anti-cheat tools such as Blizzard’s Warden, PunkBuster, or HackShield are considered “technological measures” protected by the DMCA. Thus, if the bot or cheat software has been designed to “fool” the anti-cheat tool—for example, by disguising itself so it is not detected—that will give rise to a DMCA claim. The Glider case also made clear that “copy control” and “access control” are two separate concepts. So, even though Warden did not prevent a user from copying in-game assets or code, it was nevertheless an effective “access control” technology (and thus protected by the DMCA), because it prevented users from accessing the “dynamic virtual world” created when the World of Warcraft client and server interact with each other.

Section 1201 of the DMCA can be an extremely powerful weapon. DMCA claims largely rely on technical facts, and thus often can be decided before trial. Additionally, the DMCA (17 U.S.C. § 1203(c)(3)) allows the plaintiff to recover statutory penalties of up to \$2,500 (and no less than \$200) **per act** of circumvention. Courts have interpreted this to mean that each time a copy of a bot or cheat is distributed the defendant is entitled to a separate award. Thus, in *Blizzard Entertainment, Inc. v. Bossland GmbH*, the court awarded Blizzard in excess of \$8.5 million, multiplying the minimum statutory damages award of \$200 by 42,818 copies of the defendant’s products distributed in the United States.

Likewise, in *Blizzard Entm't, Inc. v. Reeves*, 2010 U.S. Dist. LEXIS 85560 (C.D. Cal. Aug. 10, 2010), the court entered judgment against the defendant for more than \$85 million, based on the fact that many thousands of individuals used the defendant's emulated server and the defendant had acted knowingly and willfully.

However, the DMCA may not apply in every case. Many bot or cheat makers are aware of the Glider case and thus have sought to design their products so that they do not actively attempt to avoid or fool anti-cheat technology. The cheats may operate from "outside" the game client or server, such as by analyzing data from the user's personal computer before or after it has been received from the game server. The precise contours of the DMCA are still somewhat uncertain. Thus, a DMCA claim may be stronger or weaker, or may require extension of existing law, depending on how the cheat or bot operates. Thus, whenever considering a DMCA claim, it is advisable to involve technical experts to help evaluate the application of the law to the technology.

**Intentional Interference with Contractual Relations:** While the DMCA (a federal statute) is designed to protect a company's technical anti-cheat measures, state contract and tort law provides protection for the company's contractual measures (e.g., the EULA).

When a player uses a cheat or bot in violation of the EULA, that is a clear breach of contract. Thus, game publishers are entitled to damages or other remedies for their breach. Unfortunately, suing players for damages each time they cheat is not a practical approach, and the damage caused by an individual player likely will not justify the cost of litigation. Most game publishers thus have enforced their EULAs via individual or collective account bans (i.e., ban waves). These have some deterrent effect, but have not completely solved the problem.

A more effective approach is to take action against the seller or distributor of the cheat or bot software. To do so, game publishers have looked to the tort doctrine of intentional interference with contract. Under this theory, a defendant may be liable in tort where he or she is aware of the existence of a contract between the plaintiff and a third party (in this case, the EULA between the game publisher and player) and knowingly and intentionally causes the third party to breach the contract.

Video game cheating software presents a unique, and particularly insidious, type of interference, because the intent of the defendant is actually to cause multiple and repeated breaches of contract without the plaintiff becoming aware of the breaches. The aim of the cheater is to receive the benefits of the EULA (i.e., access to the game) on an ongoing basis, while secretly violating his or her contractual obligations. Moreover, to be liable for interference, the bot seller need not have direct contact with its customer. The fact that the product cannot be used without breaching the contract should suffice. Thus, in the Pocket Gnome case, a California judge found that a bot seller had induced Blizzard's customers to breach the Battle.net EULA when it advertised, marketed, developed and sold a bot that had no purpose other than to allow users to cheat in World of Warcraft.

Intentional interference claims have the distinct advantage of being relatively straightforward, both as a legal and factual matter. They also do not require complex technical analysis or extensive factual discovery. Usually, bot makers make no secret of their knowledge that to use their products their customers must violate the EULA. In fact, in the Pocket Gnome case, the defendant's "FAQ" stated: "Pocket Gnome is absolutely against the [Terms of Service]. There aren't enough superlatives in the English language to fully convey how against the rules this is. If you get caught, you will probably be banned."

Contract-based claims are not without their own set of challenges. Chief among these is that interference or other contract claims do not carry statutory penalties. Thus, to recover monetary damages it is necessary for the game developer to prove the amount of harm that it has suffered. Additionally, since interference claims are state law claims (rather than U.S. federal law claims), there is some variation between states. Some states, for example, require that the plaintiff prove that the interference was "without justification." In the Glider case, the defendant attempted to argue that its interference was "justified" because its bot made it easier for time-crunched World of Warcraft players to play with their friends. The Court gave some credence to, but ultimately did not rule on, this "justification" theory.

**Copyright Infringement:** Claims for copyright infringement have become less prominent over the past few years. This is largely the result of the Glider case.

Prior to 2010, there was some support for the theory that installing and executing a game client on a user's personal computer while running bot software was an act of copyright infringement. The theory, as discussed in *Davison & Associates v. Jung*, 422 F.3d 630 (8th Cir. 2005), was that any use of the game that violates the terms of the EULA revokes the license to use it and, thus, would be an unauthorized, infringing use. However, the court in the *Glider* case limited this infringement theory.

A second theory of copyright infringement relies on the argument that when a person changes the way a game plays, that constitutes a violation of the derivative-work or adaptation right. This theory faces a potential obstacle due to the 1992 case *Lewis Galoob Toys, Inc. v. Nintendo of America, Inc.*, 964 F. 2d 965 (9th Cir.), which held that a Nintendo peripheral (the "Game Genie") that granted players unlimited lives did not create a derivative work because the changes it effected were only temporary. *Lewis Galoob* did not involve, and predates by many years, the complex multiplayer online games that are popular today. *Lewis Galoob* also focused on the technology of the time (namely, game cartridges and consoles). Thus, it may not apply to more contemporary cheating or hacking software that, for example, injects code into a computer's memory or that renders a secondary screen display or overlay. It also should not apply to hacks and cheats that rely on client-side modifications, especially those that permanently alter the game client.

**Computer Fraud and Abuse:** Claims under the federal Computer Fraud and Abuse Act ("CFAA") or state law equivalents are viable under some circumstances. The CFAA makes it illegal to "knowingly and with intent to defraud, access a protected computer without authorization, or exceed authorized access, and by means of such conduct further the intended fraud." CFAA claims are most useful where the cheat or hack interfaces with the game server (as opposed to the client). For example, if the bot maker has used fake, fraudulent, or hacked accounts to access a game server in order to build or develop software to undermine the functioning of a game, that might be a violation of the CFAA. Also, CFAA claims should apply to those who engage in overtly malicious activity, such as hacking user accounts or causing a denial of service attack. Closely related to CFAA claims are claims of civil trespass, based on the somewhat novel argument that bots (especially spam or chat bots) burden and harm (and thus trespass on) a company's computer servers or network.

## I Some practical issues

Often the biggest challenges in anti-bot or anti-cheat litigation are not the merits of the claims themselves, but practical and procedural hurdles. Sophisticated cheat sellers employ a variety of machinations to avoid liability or to evade the U.S. court system. These include, for example, the use of offshore shell corporations as vehicles to hold corporate assets such as websites, domain names, bank accounts, vendor contracts, and intellectual property. Many bot sellers outsource aspects of their operations to individuals around the globe, such as by employing part-time freelance “contractors” to do coding or debugging work, having customer service done by forum “moderators,” and distributing their product via peer-to-peer networks. Once caught, bot sellers may shutter their operations, only to later distribute the same software under a different name. They also may destroy evidence or “cleanse” their message boards.

Such conduct poses a variety of challenges for plaintiffs, including jurisdictional and venue challenges, challenges in identifying the responsible party, and ultimately challenges in enforcing judgments. Thus, when litigating against bot or cheat sellers, it can be important to involve investigators or researchers early in the case. It also is important to retain flexibility in litigation strategy, since it often is impossible to know in advance of a lawsuit exactly where the evidence will lead. Fortunately, in the United States, broad discovery rules enable plaintiffs to explore corporate relationships and, depending on the circumstances, courts often allow pleadings to be amended to add new defendants as they are discovered.

As the market for multiplayer games and competitive “e-sports” increases, there inevitably will be growing pressure on game publishers to take aggressive steps to curb cheating, hacking, and botting. Thus, U.S. law certainly will continue to develop over the next few years, and additional legal theories may become viable. In the meantime, game publishers can take comfort in knowing that a number of legal remedies are available to them and that there are a growing number of successful anti-cheat lawsuits that can be looked to as precedent.



# Brazil Legal Update

**Vanessa  
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For the past years, the gaming scenario in Brazil has been evolving, with major companies now interested in evaluating the best manner to explore the country's growing player community. We aim to provide a brief insight into the main aspects of the Brazilian legal scenario that companies should consider to render services or operate in Brazil:

## **| Intellectual property and merchandizing**

The Brazilian IP protection system resembles that of most civil law countries in Europe, with small peculiarities that should be observed, such as the fact that Brazil's copyright legislation does not have work-for-hire equivalent provisions. Merchandizing is becoming important in Brazil, with most companies relying on the goodwill of known marks to boost sales, but to operate in this market gaming companies need to get insight into the local world of complex licensing.

One clear example can be found in the object of the licensing itself. Almost all major elements of a game (i.e. characters, costumes, game design, among others) will enjoy an overlap of trademark and copyright protection that can prove to be a strategic point to local merchandizing deals.

The licensing of trademarks (and other industrial properties) in Brazil is heavily regulated by the Brazilian PTO (Instituto Nacional da Propriedade Industrial – **INPI**), that imposes royalty limitations and agreement recordation as a condition to the remittance of royalties abroad, tax deductions of royalty payments and enforceability of the agreement against third parties. Another important factor is that trademark licensing has limited tax deductions (currently 1%). The same cannot be said for copyright licensing that not only is not under INPI's purview but also enjoys laxer tax deduction regulations. This is a strategic point to almost all negotiations, with numerous alternatives developed to outweigh risks and benefits.

On another note, gaming companies should view IP as an essential tool to regulate the conduct of their users in Brazil. In light of the still inexperience of Brazilian Courts to deal with gaming litigation, it might be easier to attest IP infringement in a legal demand (e.g. extrapolation of the scope of the EULA; non-authorized use of the trademarks – game title; logo, characters, etc.) than to prove unfair competition or usurpation of good will. For that matter it is very important to have a strong IP protection strategy for Brazil, with measures such as the constant updating of the EULA to cover or ban current market practices, among others.

# | User litigation and consumer protection

Brazil is quickly gaining a reputation in the gaming community as a user litigation prone country. This can be attributed mainly to two different factors: (i) the protection of game users in Brazil as consumers and (ii) the protections afforded by the Brazilian Legal System, which we will analyze in the following item. The best way to understand consumer protection in Brazil is to get an insight into the mindset of its regulations.

There is a strong legislative interference in all matters related to consumers in Brazil, which is reflected in most of the provisions of the Brazilian Consumer Protection Code (Código de Proteção e Defesa do Consumidor - “CDC”). The guiding principle contained in the CDC is that consumers are always the underprivileged party in a consumer relationship and as such they must be protected against possible abuses performed by suppliers. Therefore, when assessing the liability of suppliers, only the consequence of the act (i.e. the consumer’s misunderstanding) is considered, regardless of the suppliers actual intentions (if it was in good or bad faith) or if it was due to a positive act or due to an omission of the supplier.

Following this reasoning, CDC allows consumers to request a shift in the burden of proof of legal actions. For example, it might be up to a gaming house to attest the wrongdoings of a user that lead to their exclusion from the game, so users are prone to file lawsuits without actual evidence of their case.

To prepare for the Brazilian litigation scenario, gaming companies should strategically review certain aspects of their operations to cover all foreseeable loopholes, such as the nationalization of all contractual relationship established with end users and storage of user activity information. In fact, the majority of all user litigation in Brazilian Courts regards penalties applied by gaming companies in situations where there is evidence of either hacking or others conducts against the game’s Terms of Use/EULA. Courts have been increasingly ruling against users whenever they find clear evidence of informed consent to the provisions of the Terms of Use/EULA.

# I Judiciary system

Initially it is important to indicate that Brazilian Courts are notoriously slow, especially considering the high volume of cases started each year. Currently game users have the following legal alternatives:

(i) File lawsuits before Local State Courts: the duration of legal procedures varies according to state, for São Paulo its around 4 to 6 years, more if there are appeals to superior courts;

(ii) File lawsuits before Small Claims Courts (Juizado Especial Cível – “JEC”): duration of legal procedures is around 1 to 2 years. JEC was designed to bring efficiency to less complex legal matters, being subject to a unique set of procedural rules, such as the fact that demands: (i) can only involve amounts up to 40 Brazilian minimum base salaries, currently BRL 37.480,00; (ii) cannot rely on the production of actual expert/technical evidence; (iii) can be filed without attorney representation if up to 20 Brazilian minimum base salaries.

(iii) File representations before the Consumer Protection Foundation (Fundação de Proteção ao Consumidor – “PROCON”). This is an administrative institution that acts on behalf of the State, in the protection of consumer rights. No attorney representation is needed to represent a company before PROCON, that may impose hefty civil fines or determine obligations such as a duty to perform counter-advertisements.

So in practice it is possible file with little monetary impact, since in addition to the above users may also request, and in fact often do, an exemption of payment of court costs. The market sees this as a facilitator to the high user litigation demand in Brazil. What we should note, however, from our analysis of these cases, is that it is possible to considerably mitigate the chance of success of these demands.

## | Tax

The first thing to know, Brazil does not have a single “VAT”. In its place there is a series of consumption taxes (Municipal Tax on Services – ISS; State Tax on sale of Goods – ICMS; social contributions on import of services and goods; among others) that will apply depending on the particularities of the transaction.

The licensing of in-game features is a perfect example to illustrate this. Although there is still considerable debate about the matter, being strictly formal, most foreign base MMORPG may subject the Brazilian resident users to the payment of Tax on Currency Exchange -IOF-FX; ISS; ICMS and Withholding Income Tax –WIT, with a total burden than can surpass 35% of the feature price. In practice, however, users might end up only paying IOF-FX, which is withheld by credit card companies.

The current legal tax scenario for gaming companies is changing by the day in Brazil, and the main challenge is to figure out how operations shall be qualified. In a scenario like this, tax planning is crucial, not only to optimize the tax burden, but also to avoid possible tax contingencies.

## | Data privacy

Brazil’s data privacy framework has changed significantly in the last few years, in a legislative process that is still pending completion. The starting step was the enactment of the country’s first data privacy law, Federal Law n. 12.965/14 (“**Brazilian Internet Data Privacy Law**”) in June, 2014, which unique purpose is to regulate the principles, warranties and duties related to the use of internet in Brazil. In summary this means that this legislation does not cover the protection of personal data itself, so Brazil does not qualify for any EU data transfer safe-harbor. A regulation of personal data will be enacted in the foreseeable future.

As long as one of their users is located in Brazil, the Brazilian Internet Data Privacy Law will apply to regulate data collection, storage, use and treatment by gaming companies that need to

adjust their Terms of Use/Privacy Policy as well as their data policy to local legislation. Failure to comply with the law may result in civil penalties ranging from fines to the banning of activities in Brazil. Also, recently both Google and Facebook Brazil have had their executives under treat of arrest for failure to comply with an order to compel their foreign entities to deliver data or access requested by Brazilian Authorities.

## **I Violent content and age ratings**

Brazil has a very interesting view on the role of age restrictions and ratings in the gaming industry. In the last years, a few games have had their distribution prohibited locally (or under threat of) due to violence or inappropriate content, with legal demands opposing freedom of expression and child protection warranties, creating a form of duality that could justify state censorship. The solution of the Courts to remove child protection from the equation has been age ratings, seeing in this an important mechanism to claim that children will not gain access to content inappropriate for their age.

Age ratings and classification are regulated by the Ministry of Justice of Brazil that has developed a complex classification system per age group that takes into account local cultural characteristics. In certain cases, games may be free-rated (conditioned to certain criteria) or subject to classifications by IARC (International Age Rating Coalition). Therefore, it is very important that even if the games are self-rated, gaming companies be aware of the Brazilian classification criteria, to have more robust arguments in case of any legal demands. Also, since this argument is still far from consolidated in Brazil, gaming companies should be very mindful of conducts that either facilitate or promote underage access to the game.

On another note, it is important to keep in mind: (i) that age ratings regard solely the appropriate age for distribution/use of the game, which differs from the age of consent in Brazil; (ii) promotional events (or any other of the kind) that will involve the participation/attendance of children/teenagers (up to 17 years old) may be subject to previous judicial clearance; (iii) advertising targeted to children/teenagers in Brazil is regulated, and right now this is aggravated by a conservative movement that aims to ban any such ads from Brazil, so it is important to circumvent liability in these cases.

# | E-sports regulations

Brazil is on the early stages of establishing its legal framework for esports, which is an interesting challenge in a country that has very specific regulations and practices for sports. Among other legislations, sports in Brazil are subject to Federal Law nº 9.615/98 (“Pelé Law”). Pelé Law does not provide any objective legal criteria to define or exclude which sports it regulates, in fact with the sole exception of soccer, no other sport is even mentioned. Currently there are 2 proposals to amend Pelé Law and include “virtual sports” under its terms, with the formal recommendation of the Sports Commission of the House of Representatives to reject one of them under the argument that the law already indirectly covers esports.

Pelé Law in very general terms regulates the activities of professional and non-professional athletes, clubs, leagues and entities of administration of sports, establishing duties and obligations. The challenge is to fit esports into a legal framework that was not designed to regulate it and does not take into account its peculiarities. As a clear example, we can cite the notorious *direito de arena* (“Arena Right”). This is an exclusive right of clubs (and not championship organizers) to negotiate and prohibit the capture, fixation, emission, transmission and reproduction of the sports events it participates. In other words, in Brazil in order to transmit a game on TV, broadcasters have to negotiate directly with the clubs. This right stems from the fact that the audience attraction of almost all sports events comes directly from assets of the clubs (player selection and training in association with their brands). The scenario certainly changes for esports events, where the IP from the games still takes a co-chair or front seat in attracting audiences.

This is just one example of the discussions currently being held in Brazil on the matter of esports that should get even more heated this year due to a congressional movement to enact a new legislation that will substitute Pelé Law. It is important for gaming companies to take a front role in participating in these debates.

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# IP Knowledge

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# IP Knowledge

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# | Esports

On 7 October 2016, French Parliament passed a law creating a legislative framework for e-sports which includes the following:

- free organisation of physical video games competitions which must merely be declared to administrative authorities;
- establishment of a parental consent scheme for underage players; and
- creation of a specific fixed-term contract for employee professional players which cannot be concluded for less than twelve months, unless it was entered into for a season that is already under way for replacement purposes, and for no more than five years. Such fixed-term contract must comply with a certain number of formalities. Failure to comply with such rules is sentenced by a fine in the amount of 3,750 euros.

A decree detailing and implementing the law will be adopted by the end of April 2017 according to the French Minister of Economy.

# | Tax incentive to support the creation of video games

On 1 January 2017, French Parliament passed the French Finance Act for 2017 creating a new tax credit mechanism involving the creation of video games.

The French Finance Act increased (i) the tax credit rate for the creation of video games from 20 % to 30 % of expenditure on conception and creation and (ii) the ceiling per undertaking from 3 million euros to 6 million euros.

The conditions of eligibility for such credit are that the video game:

- has a cost of development of at least 100,000 euros;
- is intended to be effectively marketed to the public;
- is mainly created by authors or creative collaborators who are French, nationals of a Member State, or another state party to the EEA Agreement with which France has a Tax Treaty;
- contributes to the development of French and European creation and diversity;
- does not contain pornographic or extremely violent sequences.

Eligible expenditures include:

- Depreciation on assets other than buildings created or acquired new
- Remuneration paid to authors who participated to the creation of the video game pursuant to an assignment agreement
- Personnel costs related to employees and related social security costs as well as salary expenditures of technical and administrative employees
- Other operating expenditures (purchase of material, rent, building upkeep...)
- Sub-contracting expenses (>1.000.000 euros)

## I Disabling of player accounts

Two AION players, displeased by the fact that Gameforge 4D had permanently disabled their online player accounts, initiated an action against Gameforge 4D before the judge in charge of summary proceedings of the Grenoble First Instance Court to obtain the reactivation of their player accounts. The players claimed that Gameforge 4D lacked any valid reason to disable their player accounts which had caused them harm, notably since the characters created on the platform had gained a reputation. Gameforge 4D claimed that the players had violated its terms of use by engaging in inappropriate behaviour with the other players and that it was therefore entitled to disable their accounts.

Overruling the order of the judge in charge of summary proceedings, the Grenoble Court of Appeals held on 3 May 2016 that the disabling by Gameforge 4D of player accounts constituted a manifestly unlawful disorder for the players since Gameforge 4D was unable to put forward any evidence of a violation of its general conditions of use.

## **Non compliance with the official release date (“day one”)**

Electronic Arts Publishing initiated an action before the judge in charge of summary proceedings of the Lyon Commercial Court to obtain an injunction against a video game reseller offering the video game FIFA 15 for sale before the official release date and at a lower price.

Overruling the order of the judge in charge of summary proceedings, the Lyon Court of Appeals notably held on 31 May 2016 that the video game reseller was not bound to comply with the alleged official release date as (i) there are no legal provisions for this purpose, (ii) there were no contractual provisions between the parties as the reseller was not an Electronic Arts distributor, and (iii) the claimant did not prove that the “day one” practice was an established commercial practice. The Court further noted that the sale below the price recommended by Electronic Arts was not sufficient in itself to constitute misconduct.

The Court therefore dismissed Electronic Arts’ action and notably ordered it to publish the decision on its website and in three specialised publications.

## **Copyright ownership and infringement**

Frédéric Raynal, former employee of Atari, initiated an action before the Lyon First Instance Court claiming authorship in the game “Alone in the Dark” and copyright infringement by Atari.

The Lyon First Instance Court held on 8 September 2016 that the video game “Alone in the Dark” was a work of joint ownership and that the copyright was not held by Atari, but by the persons who participated in the creation of the game. The court notably took into account the horizontal mode of creation of the game between the various authors and the fact that Atari did not direct and only minimally took part in such creation.

In particular, the Court held that Frédéric Raynal appeared to be the author of (i) the software in versions 2,3,4 and 5 of the video game “Alone in the Dark” and (ii) the game play. The Court designated a judicial expert to quantify the compensation he is entitled to for the unauthorized use of his work.

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# **Japanese Payment Systems Regulations and Marketing Regulations Online Game Companies**

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# | Introduction

It is not difficult to start an online game business by delivering game applications on smart phones and tablets. No license or permit from a government agency is required for distribution of game applications online, or for making them available for Japanese users to play them. Japanese law does not require foreign game companies to create a subsidiary or branch in Japan when they are simply making game applications available through the Internet.

When a game company begins selling in-game currencies, which can be used for purchasing items used in online games, such as avatars, weapons or fuels, or when it launches a campaign distributing promotional items for its customers in Japan, there are regulations that must be followed by game companies whether they are based inside or outside of Japan. These regulations on payment systems and marketing can be overlooked by foreign game providers.

# | Payment Systems

Sale of game items tends to involve sale and use of in-game currencies. A game provider will sell in-game currencies (e.g. Stars, Gold or Diamonds) to users of its game for a certain amount of Japanese Yen. When a user purchases game items, instead of paying real money, in-game currencies will be used and debited from his/her account in the game. Such sale of in-game currencies to users is a form of pre-payment of the purchase price for game items or other services that the user will purchase from the game provider in the future. Japanese law imposes certain regulations on issuers of prepaid payment instruments.

## **Prepaid Payment Instrument**

What are “prepaid payment instruments”? Under the Act on Settlement of Funds (“ASF”, or Payment Services Act), prepaid payment instrument (“PPI”) means (i) certificates, electronic devices or other things, or numbers or other signs; (ii) issued for consideration corresponding to the amount or quantities of goods or services recorded on such things or recorded elsewhere by electronic means; and (iii) which can be used, by presenting or notifying it, for payment of the

purchase price or service fees to, or for claiming delivery of goods or provision of services by, the issuer or person designated by the issuer. PPIs can be tangible or intangible. They can either indicate an amount of lawful currency (including corresponding number of other units such as Star) or quantities of goods or services that the holder can claim (e.g. number of bottles of beer). They should be able to be used for payment to the issuer and/or other parties designated by the issuer. There are exceptions to the definition of PPIs prescribed under the statute, including movie tickets or entrance tickets to stadiums or museums, or instruments that expire within 6 months. In-game currencies issued by game providers usually fall under the definition of PPI.

What regulations will apply to issuers of prepaid payment instruments? It depends on whether the PPIs can be used for purchasing goods or services only from the issuer and/or its affiliates, meaning its subsidiary or parent company holding more than 50% of voting stock, or its sister company under at least 50% common ownership (“PPIs for Own Business”), or for purchasing goods or services from the issuer and any third parties designated by the issuer (“PPIs for Third Party Business”). Requirements for notification or registration, as well as reporting obligations and security deposits apply as described below.

### **Notification Requirements**

No prior license, permit, or registration is required to issue PPIs for Own Business. When the aggregate unused amount of issued PPIs as of the end of March or September exceeds 10 million Japanese Yen, the issuer needs to file a notification to a local finance bureau and make a security deposit within 2 months.

Unused amount of PPIs as of the end of March or September (“record date”) is called the “Unused Base Date Balance”, and it is calculated by deducting the amount of PPIs used or expired from the amount of PPIs issued through the record date. When PPIs indicate a quantity of goods or services, for the purpose of calculating the Unused Base Date Balance, such quantity will be converted into an amount based on the normal price of such goods or services charged to users. In-game currencies may be sometimes given to users for free such as bonus points. In such cases, if free and paid in-game currencies are clearly distinguished for users and separately accounted for on the books of the issuer, such free portions of in-game currencies will not need to be included in the calculation of the Unused Base Date Balance.

Notification documents for PPIs for Own Business include various information including contact information in Japan, types of PPIs, pricing, structure chart showing how PPIs are issued and used, information regarding affiliates, terms of use, etc.

Can a foreign corporation file a notification of PPIs for Own Business and make a security deposit? The ASF prohibits a person engaging in the business of issuing PPIs in a foreign country from soliciting purchases in Japan of PPIs issued in a foreign country. Current practice before local finance bureau is that notification by a foreign corporation will be accepted only if it has a branch or office in Japan. The regulator also accepts a notification filed by a Japanese subsidiary of a foreign corporation. Filing through a Japanese subsidiary would require structuring proper legal relationships between the parent company and subsidiary, taking into account business, finance, tax and accounting matters.

### **Registration Requirements**

With respect to PPIs for Third Party Business, the issuer must be registered before issuing such PPIs. In-game currencies which can be used for purchasing goods or services from third parties which are not affiliates of the issuer will fall under PPIs for Third Party Business.

An application for registration as issuer of PPIs for Third Party Business will be denied if the application meets certain negative criteria, including the applicant is a foreign corporation which does not have a branch or office in Japan, or the applicant does not meet the net asset requirement prescribed under the regulations. The net asset requirement is 10 million Japanese Yen for an applicant which engages in business only within a city or town, and 100 million Japanese Yen for an applicant which engages in business in two or more cities or towns.

### **Reporting Requirements**

Issuers of PPIs which have filed a notification of PPIs for Own Business or a registration of PPIs for Third Party Business will be required to report the Unused Base Date Balance as of each record date within 2 months. If there are changes to the matter notified in the initial notification the issuer must notify such changes without delay. If an issuer makes changes to types or price of in-game currencies, such change will need to be notified.

## **Security Deposit**

Issuers of PPIs which have filed a notification of PPIs for Own Business or a registration of PPIs for Third Party Business must make a security deposit in an amount equal to 50% or more of the Unused Base Date Balance within 2 months from the record date on which the Unused Base Date Balance has exceeded 10 million Japanese Yen. The security deposit is intended to protect holders of PPIs in the event of breach by, or insolvency of, the issuer.

The deposit will need to be made by cash or government bonds or other bonds designated by the government to an official depository. The issuer can also fulfill its obligation by entering into a guaranty agreement or trust agreement with a Japanese financial institution. With respect to each record date, the issuer may need to make an additional security deposit based on the most recent Unused Base Date Balance.

The security deposit bears interest set by the government. The security deposit made to the official depository can be refunded to the issuer when the Unused Base Date Balance falls below 10 million Japanese Yen, or when the amount of the security deposit exceeded 50% of the Unused Base Date Balance (refund will be made for the excess amount).

## **Indication or Provision of Information**

Issuers which have filed a notification of PPIs for Own Business or a registration of PPIs for Third Party Business should indicate information including the name of the issuer, expiration period (if any), contact information, places where PPIs are accepted on PPIs or, if no tangible material is provided together with PPIs, provide such information through electronic means.

## **Refund of PPIs**

Issuers of PPIs have the obligation to refund PPIs in the event of discontinuation of business pertaining to the PPIs or in the event of cancellation of registration of the issuer of PPIs for Third Party Business. PPIs cannot be voluntarily refunded except for the limited amounts prescribed under the regulations. Such exceptions include where the amount of refund within a 6 month period ending on a record date does not exceed 20% of the amount of PPIs issued during the previous 6 months period, and where the amount of refund within a 6 months period ending on a record date does not exceed 5% of the Unused Base Date Balance as of the previous record date.

# | Promotional Items

Promotional campaigns often involve giving promotional items to consumers. The value of premiums and manner of providing premiums is regulated under the Act against Unjustifiable Premiums and Misleading Representations and relevant rules and regulations (“Premiums Regulations”).

## Premiums

Under the Premiums Regulations, “premiums” are any article, money, or other kinds of source of economic gain given by a business as a means of inducing customers in connection with a transaction involving its goods or services. Items in online games can be premiums, if given by the game provider to users to induce users in connection with transactions with the game provider. Premiums can be given in various forms – they can be given by way of lottery or as a prize for a competition, or they can be given to all users participating in certain promotional campaigns.

## Limit on the value of premiums

When premiums are given by way of lottery (including competition), the value of each premium must not exceed an amount equal to 20 times as much as the relevant transaction value or 100,000 Japanese Yen, and the total value of the premiums must not exceed 2% of reasonably expected sales relevant to the promotional campaign during the campaign period. Determination of the transaction value is not necessarily a simple task. If the premiums are given proportionate to the transaction price, such transaction price is the transaction value. If the premiums are given regardless of purchase price or regardless of making any purchase, the transaction value will be deemed 100 Japanese Yen, unless the minimum price of goods or services relevant to the promotional campaign is more than 100 Yen.

When premiums are given to customers without lottery or competition, the value of each premium must not exceed an amount equal to 20% of the transaction value.

When promotional items are given to any person without regard to the purchase of goods/ services or visit to the stores, such items are not “premiums” defined under the Premiums Regulations, since they are not given in connection with a transaction. Accordingly there is no limit on the value of promotional items.

#### Prohibited form of lottery

The Premiums Regulations prohibit lotteries by way of making certain combination of two or more characters, pictures or signs, because of its highly speculative nature. For example, it will be an illegal promotional campaign to randomly include in potato chips bags a lottery card indicating either A or B and give a promotional item to customers who completed a combination of A and B cards.

If a game provider sells to its users randomly selected game items (among two or more items) which will not be known to the user until consummation of the purchase, and gives a special item to users who completed the required combination of randomly sold game items, it will be an illegal practice. The Consumers Affairs Agency made a comment on its website that it will also be illegal that (i) randomly purchased item A will have enhanced effect by combining item A with item B where item B will disappear by combination; or (ii) randomly purchased items A and B will become item C upon combination.

On the other hand, it is permitted to give a prize to users depending on aggregate number of points indicated on each purchased items, or to users who collected certain number of the same items.

# | Conclusion

For online game companies these regulations in Japan may not be familiar in their home jurisdictions, although they could have material effect on financial success in the market. In response to recent developments of information technology and the rise of new form of businesses, regulations and the legal framework in Japan will continue to change. In addition to matters mentioned in this article, recent examples of such changes include new a framework for cryptocurrencies exchanges, and revision of data privacy laws. Online game companies interested in the Japanese market should continue to monitor new developments in these regulations.

**March 2017**



# Russia Legal Update

**Vladislav Arkhipov**



Vladislav Arkhipov is an of counsel in the IP, IT and telecommunications practice of Dentons' Saint Petersburg office. He consults Russian and international clients on a variety of issues related to Internet regulation, intellectual property, privacy and content restrictions. He also has a track record in Internet-related litigation, including disputes between companies and users, and has been considered by Legal 500, 2015 as recommended lawyer in TMT in Russia.

Mr. Arkhipov is a member of Roskomnadzor's advisory board for personal data, a consultative body through which business and community expresses concerns to this regulatory authority and back in 2015, as the head of the workgroup on definition of personal data, he advocated a reasonably narrow methodological approach to interpreting this legal concept in the age of Big Data so that formal certainty in application of law could be reached. He has been a frequent speaker at business, legal and game developer conferences (including DevGAMM, White Nights, Mastering the Game and Games Law Summit itself), as well as events organized by the American Chamber of Commerce. He has authored over 42 professional publications, to name but a few – the most recent Russian Internet Law students' manual and peer-reviewed articles on video-game law, and is an associate professor at Saint Petersburg State University teaching several courses focused on law in digital age. Video games and eSports are his long time hobbies, and he is active in promoting these among conservative audiences of legal practitioners and academics.

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# | Privacy

## 1.1. LinkedIn Case

Blocking of LinkedIn in Russia following a lawsuit of Roskomnadzor (“RKN”) was one of the landmark cases in the area of privacy in 2016. Procedurally, the court claim was filed in protection of rights of “non-determined range of individuals”. The core of the case itself was related to the fact that LinkedIn did not comply with the data localization amendment, which is the principal matter of fact. However, additionally the appellate court decision contained a few other arguments and, above all, confirmed an important jurisdictional criterion which may be re-used by the Russian authorities in future.

### **Takeaway:**

1)The court supported the approach that, at least in some cases, Russian laws can be applied to foreign companies which do not have any kind of representation in Russia, but target Russian audience through the Internet. Main criteria – Russian version of the website and possibility of showing advertisements in Russian<sup>1</sup>.

*“Close a call”: if your resource is in Russian, this may now imply a risk that at some point certain Russian laws on personal data compliance may be applied to it to certain extent, which may also give a rise to litigation and/or regulatory action in Russia.*

2)Although the case related to localization requirement compliance, RKN submitted a claim on behalf of “non-determined range of individuals”. When LinkedIn pointed out that no real claim by any individual was provided, the court considered that as irrelevant for this procedural form.

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<sup>1</sup>The court also used a broad analogy to Article 1212 of the Civil Code which allows application of the Russian law in consumer-related conflicts between Russian consumers and foreign traders. This Article was also used before in some genuine private consumer-related cases with foreign Internet companies. Other than that, there are almost no rules which could directly be interpreted as allowing such kind of ‘long arm’ application of the Russian laws.

3) Within LinkedIn structure, the claim was addressed to U.S. registered LinkedIn Corporation (domain name owner), and not LinkedIn Ireland (actual party to T&Cs). The court considered the domain name owner as the proper defendant.

*“Close a call”*: it is a rising trend in Russian Internet-related case law, in some other cases too, to consider domain name owner as proper (co-)defendant for website-related matters even though in reality the website may be operated by other companies.

4) In addition to localization requirements, part of RKN's claim was based on the fact that when contact lists are synchronized using LinkedIn's applications not all of the third-party persons from users' contacts (e.g. on a smartphone) may be considered as having provided consent for processing their data.

## 1.2. Increase of Regulatory Attention – Inspections

During recent time RKN, authorized to perform “field” inspections on personal data compliance at entities located in Russia, becomes more active and more thorough, often going deep into details. In the course of the inspection, officials may come to office of a company, interview employees and check specific random examples of documents. While the fines are relatively low comparing to the EU (up to Rubles 10 000 or app. Euro 167 now, and [aggregated, for number of separate kinds of infringements] up to Rubles 290 000 or app. Euro 4 800 from July 2017), and sometimes inspections result in just remediate actions order with a few months provided for compliance measures, the whole affair may be cumbersome for a company distracted from normal business. The most recent inspections show more detailed scrutiny which includes now analysis of which Internet services company uses.

### **Takeaway:**

1) Russian-located entities may be subject to “field” inspections by RKN which can be scheduled (normally, those who have notified RKN in advance according to the law on commencement of personal data processing) or non-scheduled, initiated e.g. after a claim of a disgruntled individual – a user, or a former employee to name but a few categories.

*“Close a call”: if you have a Russian-located entity which operates with personal data (almost anyone operates with personal data of employees in any case), it might be worthy to invest some time into personal data compliance matters, especially if this entity deals with user communication where the conflicts nowadays may not always be extinguished at the level of customer support.*

2) Inspectors most likely will arrange one or more (up to five, in our most recent experience) personal meetings to take interviews from various employees about what they know on personal data matters and to review compliance on spot, from having a look at day-to-day documents to visually checking workplaces to see whether some random printouts containing personal information are insecurely scattered on tables.

3) RKN would request a lot of documents for review. Mainly, these would include internal documentation required under the personal data legislation, and customized clarifications on how some non-standard procedures and aspects of data processing are arranged. Flowcharts, schemes and spreadsheets which company may have in advance for other purposes may be well-used for some of the questions.

4) Among “weak points” which RKN identifies quite often are: processing of job applicants’ data without proper consents gathered in advance, transfer of data to third parties without proper contractual clauses (even within one holding – each separate entity is formally considered as third party), personal data localization and cross-border transfer.

5) In many cases RKN now specifically requests information on Internet services used (to name but a few, from one of RKN’s orders on inspection – Yandex.Metrika and Google Analytics), and personal data processed in desktop and mobile apps. Some of the services may be found in violation of the localization requirement, e.g. foreign cloud storage without properly formalized initial entry-level Russian database.

# Content Regulations and Protection of Children

## 2.1. Direct or Indirect LGBT Content

It would not be news nowadays that LGBT content, or content which shows support to LGBT, is considered as sensitive and implying legal risks in Russia. The legislation makes an administrative offence of “propaganda of non-traditional sexual relationships among minors” (Article 6.21 of the Code of Administrative Violations). The definition of such “propaganda” includes several kinds of actions with a common feature of being targeted to minors and portraying such relationships in a positive or attractive way. Some media companies were already fined for this, and the fine is Rubles 1 mil. (app. Euro 16 770). Even more so, there are examples of video game companies either being dragged into scandal with LGBT content, or taking some measures proactively.

### **Takeaway:**

1) Showing LGBT content in positive context for anyone below 18 years old may cost Rubles 1 mil. of administrative fine and, eventually, website blocking if not removed. LGBT “propaganda” is anything which induces minors to try a “forbidden fruit”, shows its attractiveness, asserts equality to “traditional” relationships or is just annoyingly obtrusive.

2) A “lad’s magazine” MaximOnline was fined exactly with Rubles 1 mil. for the article “Plan B. Sexual Master-Class from Lesbians” (the content was consistent with the title). The court found important that the website was rated 16+ (and not 18+), so that the minors of the age in between could be affected by this article.<sup>2</sup>

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<sup>2</sup> However, the article still can be found cross-posted to some other Internet resources.

*“Close a call”: if your video game contains some kind of LGBT-content and is targeting Russian market, these aspects may well worth additional legal consideration. This also relates to other sensitive content, including any materials which are considered not appropriate for minors, e.g. “traditional” extreme violence.<sup>3</sup>*

4) Other video game company was in consideration whether there was a possibility to add content to one of their titles where one of the main characters would make a coming-out and be eventually perceived as an open lesbian. Due to the risky nature of the information in the Russian context and not wishing to unnaturally raise the rating to 18+ the content was removed for the Russian update (for some other countries too).<sup>4</sup>

## 2.2. Access to Pornography – YouPorn and PornHub

Blocking of pornography resources in Russia is not something uncommon nowadays too. However, two resources managed to lift the blocking, at least in part. YouPorn and Pornhub were blocked pursuant to court decisions which later were appealed. At the time of writing this piece, genuine .ru domains of the websites are blocked, but “international” version of Pornhub and a special “youpornru.com” page became accessible after the services added a special introductory page (instead of YouTube-like aggregation of videos on the front) where user should read the corresponding warning and confirm his/her age.<sup>5</sup> RKN itself even tweeted about unblocking of Pornhub and made an ironic comment that the unblocking is dedicated to the birth of Ru-net, celebrated on April 7. However, it does not seem that approach to pornography is a settled matter in Russia, and things may change in future.

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<sup>3</sup>Note that there also are other categories of publicly offensive content which is prohibited for anyone, even mature audience (e.g. detailed suicide descriptions or even information which portrays Soviet army out of Russian historical standards).

<sup>4</sup>T Still, Russian users were not unaware of the situation due to accessibility of information in updates released to the Western countries.

<sup>5</sup>A reservation: some Internet providers may still have the block up, and there can be changes of situation depending on the time you read this.

### Takeaway:

If your resource contains some spicy content which cannot be shown in Russia to anyone below 18+ (and there are additional categories besides porn), the expectation of Internet monitoring authorities is that there would be at least some kind of barrier for users. Simple confirmation of age and commitment to relevant T&Cs seems to work for now, although there can be doubts that this approach could really survive further development of Internet regulation in case it becomes even stricter.

## I Internet Communication

In addition to personal data localization which is regulated separately, from 2014 Russian law also has a rule prescribing Internet communication services to store in Russia information on communication between Internet users related to Russia by IP, geolocation data and similar criteria (from 2018 – also the contents of their communication according to “Yarovaya Law”) and, among other consequent obligations, to provide access to such data to law enforcement agencies according to their requests if they are based on proper procedural legal rules. So far this rule was applied to Russian-registered companies. Recently one of the first foreign messengers – Threema – was added to the registry. And some time thereafter RKN forwarded notice on incompliance to Zello, a mobile walkie-talkie service. Zello is currently blocked in Russia for infringement of its obligations as “organizer of information distribution in the Internet”, a formal concept used for such kind of services in Russia.

### Takeaway:

Like it happened in LinkedIn case, the very fact of targeting foreign Internet service not having a local representation in Russia by compliance notices means that Russian authorities are willing to apply the law in a “long arm” manner, and services which target Russian audience may be under fire.

*“Close a call”: similar to mentioned above, if your resource is in Russian and provides any form of Internet user communication, this may now imply a risk that at some point certain Russian laws aimed to regulate user communication may be applied to it to certain extent, which may also give a rise to litigation and/or regulatory action in Russia.*

**March 2017**



# Iran Legal Update

## Nima Abdollahzade



Nima abdollahzade is a legal counsel at Computer and Video Games Foundation of Iran. He provides legal counselling to the Iranian game developers and publishers in the fields of intellectual property, tax planning, and international regulations. His job also includes facilitating the relationship between Iranian and foreign companies. For several years, Nima has helped Iranian start-up community to overcome legal obstacles of working with the international market despite strains caused by the sanctions.

Nima is also working with Beeptunes, biggest Iranian online music platform. There, he provides legal advice to Iranian music industry with IP related matter and follows up on infringement cases worldwide. Formerly, Nima used to be a game developer and co-founded Aparon Game studio. He was also a senior mobile programmer for 5 years.

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## | Iran game market

With over 23 million players, Iran is the biggest market for game publishers and developers in the middle east. Iranian and foreign companies have earned more than 153 million dollars in net revenue in 2016 and it is expected that their revenue will grow significantly in coming years. There is also a strong local game industry that is developing indie games within Iran. 6 publishers, 100 game studios, and 2,000 individual game developers are among this vibrant market. There are already a number of international publishers which have a presence in Iran. These include several Russian and Chinese publishers.

77% of Iranian gamers choose their smartphones as their gaming platform while 16% use their PCs and other 6% play on their consoles. 65% of the overall revenue earned belongs to mobile games while PC and console games each receive 20% and 15% respectively. Top three genres are driving/racing, runner, and puzzle among Iranian gamers. Android OS has a powerful monopoly with over 94% of Iranian mobile gamers holders choose it as their gaming platform.

## | Payment infrastructure

Past sanctions have caused Iranian banks to be isolated from international banking system, though the situation is getting better. None of the major online payment methods including Visa, Mastercard, or PayPal are available in Iran at the moment. Despite this, Iran has its own online payment platform called “Shetab”. Shetab only works within the territory of Iran and only supports local currency Rial. Any given foreign publisher that desires to distribute their game in Iran or would like to provide in-app purchases transaction method for their games should either rely on payment methods provided by the local Iranian online app stores or choose to integrate them with Shetab.

Companies (Developers and/or Publishers) from all around the world need not worry about using Shetab as Joint Comprehensive Plan of Action (JCPA) or Iran Nuclear Deal has already lifted sanctions targeting Iranian banks and major financial institutions.

## **| Taxation regulations in Iran**

Corporate tax in Iran stands at 25%. There is also a 9% value added tax (VAT). However, certain types of affiliations like cultural-oriented businesses and particular kind of companies (e.g. knowledge-based institutions) are exempted from paying taxes. There are also several free economic zones that offer a 0% tax rate in those certain geographical locations. Article 8 of “Regulations for developing and publishing of computer games” acknowledges game development and game publishing as a cultural activity and thus, the income earned by the developers and the publishers are exempted as well. However, a game publisher should add VAT to their market prices.

## **| Consumer protection**

The storage of user’s personal data is allowed under article 58 of E-commerce law of Iran under certain conditions. Clear consent of the user and the ability to remove their data by the user at any time (a.k.a. right to be forgotten) are examples of the conditions which must be met before any personal data can be stored. At the moment, there is no legal requirement which makes it mandatory to store personal data of Iranian customers inside Iran, however, this may become mandatory in near future. Offering a 7-day refund option is compulsory under article 38 of the same law, however, certain types of goods and services are exempted from this provision.

## **| Prohibited contents and Rating system**

According to “Regulations for Developing and Publishing of Computer Games”, issued by Ministry of Culture and Islamic Guidance, game publishers should submit a formal application for each game they wish to release to get both rating and release permit. The competent authority for issuance of both rating certificate and release permit is Iran Computer and Video Games Foundation (IRCG). IRCG can either issue the permit, utterly refuse, or ask for revisions in order to issue the permit. Games that include sexual content, anti-religion rhetoric, or materials that

promote criminal activities are usually denied release permit. IIRCG uses its own rating system called ESRA. Games are rated according to level of violence, strong language, etc. IIRCG will give appropriate rating to a game after duly reviewing it from different perspectives. It is possible to ask for reconsideration of given rating after making revisions to the game.

Games should also refrain from containing gambling mechanism. This included removal of any mechanism that would allow the user to convert in-game money to real money. Games that do not have release permit from IIRCG are considered to be illegal and will not be able to be published in Iran.

## **| Sanction Regime**

In Post-JCPA era, legal and personal entities can commit business in Iran freely without any concerns regarding the sanctions. Even a US-owned business that resides outside the territory of the United State can freely involve in activities within Iran. Therefore, European and Asian game publishers and developers can work freely with any Iranian partners and need not worry about sanctions.

## **| Rules for publishing game in Iran**

According to recently adopted rules under “regulations for developing and publishing of computer games” only local publishers have the right to publish games in Iran - Although not enforced yet, it is expected that from the next month (May 2017) only local publishers can publish games . Therefore, international publishers willing to publish their games in Iran either have to register a local branch in Iran or transfer the publishing right to an Iranian local publisher. Localization is not mandatory at the moment but it is expected that in near future it will be. Official language in Iran is Persian(Farsi).

The first step for publishing a game would be the submission of a formal request asking IIRCG for release permit and rating specifications. If the permission is granted, the publisher can office its game in physical or electronic form within the territory of Iran. In practice however, IIRCG tends to show some flexibility as most mobile games are published first and then ask for release permit.

# IP Law in Iran: Copyright and Trademark protection

No foreign work has copyright protection in Iran by default. That is the case because Iran is not a signatory to any of the principal copyright conventions yet including the Berne Convention and TRIPS. In national level, article 22 of Law for the Protection of Authors, Composers and Artists Rights only recognises copyright of works that are “produced, published or printed” for the first time in Iran meaning, if a company desires to enjoy copyright protections under Iranian legal regime, it needs to either first publish its work in Iran or publish its work simultaneously in Iran and other markets. Currently, Iranian government is considering to join the copyright conventions. If these attempts are successful, copyright status of foreign work can enhance significantly.

Unlike copyright protection, trademark protection of brands and names is considered to be very firm in Iran. Iran is a member of Madrid agreement as well as Paris Convention. It has also been incorporated into national law provisions of those conventions. Respecting applications can be filed online through government portal (<http://iripo.ssaa.ir/>) by the company or a legal agent.

Copyright or trademark owner can file both civil and criminal lawsuits against potential infringers in Iran. Available remedies include financial compensation, fines and imprisonment up to 2 years. There is a special prosecution office for trademark infringement cases dedicated to hearing IP-related complaints.

**March 2017**



# Ukraine Legal Update

## Oleksiy Stolyarenko



Oleksiy Stolyarenko is an Associate in the Kyiv office of Baker & McKenzie, specializing in Information Technology and Intellectual Property law. Oleksiy is advising clients on complex IP/IT, copyright, trademark, patent, domain name, the Internet & technology matters, including protection of privacy & information, issues related to technology transactions, start-ups, innovative services and products. Also he represents clients before the courts of Ukraine in trademark and patent litigation matters and carries out anti-piracy/anti-counterfeiting campaigns.

Oleksiy graduated from the National Law Academy of Ukraine named by Yaroslav Mydriy in 2005 with honors, he also received Masters Degree in Intellectual Property from the State Institute of Intellectual Property in 2008. Since 2010 Oleksiy holds LL.M. degree from Paul M. Hebert Law Center, Louisiana State University.

Oleksiy Stolyarenko is a registered trademark/patent attorney of Ukraine. In addition to that Oleksiy admitted to practice law in the State of New York and in Ukraine.

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## | What's new in Ukraine?

Ukraine has been heavily reformed in 2016 and beginning of 2017, especially in the sphere IP law. Not all reforms were successful though, and for some, it remains to see how they would work. Among the highlights we can indicate an adoption of the first ever secondary liability regime for online copyright infringement, the constitutional reform to allow the creation of the High Intellectual Property Court and liquidation of the State Intellectual Property Service (SIPS), the main government agency responsible for IP law and policy in Ukraine.

## | Supporting films with ISP liability/ What happened?

On April 20, 2017, the President of Ukraine signed into the law the previously adopted by the Parliament of Ukraine draft “On State Support of Cinematography in Ukraine.” But do not let the name of the law misguide you. Out of total 52 pages of amendments, 15 pages are devoted to establishing the first in the Ukrainian history ISP liability regime for third party copyright infringements.

This secondary liability regime is in many ways different from the ones already working in the EU and US.

It applies only to a limited number of copyrighted materials:

- audiovisual works
- musical works,
- computer programs,
- videograms, phonograms,
- broadcasts.

The rights owner can initiate the notice takedown procedure only through the attorney-at-law admitted to practice law in Ukraine. The notice itself has to comply with quite detailed requirements to its contents and must be sent in a hard copy and electronic form.

The rights owner must send the notice to the owner of the website first requesting voluntary shutdown of the infringing content. And only if the owner is not known or refuses to comply with the notice requirements, the notice could be sent directly to the hosting provider with the same demands. After that, all parties of the takedown procedure are involved in a complicated letter exchange that can ultimately result in a decision of a hosting provider to shut down the illegal content... for 10 days.

Yes, that is right, if no evidence provided to the hosting provider of an initiated court action against the website owner that opposes shutdown decision, the hosting provider will resume hosting of allegedly illegal content in 10 days.

Even though the enforcement procedure seems to be overregulated and exceedingly complex, the enactment of this law would be a big win for the IP rights owners community. That is because, previously, the illegal content could be shut down only based on a respective court decision.

**Good news, this new law will help gaming industry fighting with some of the online IP rights infringements in Ukraine.**

**Bad news, the procedure itself is quite complicated, limited and might not be effective in all cases. In addition, you will need a lawyer for that.**

## **The court that will get you/ What happened?**

On June 2, 2016 the Parliament of Ukraine adopted amendments to the Constitution and the Law of Ukraine “On the Judiciary and Status of Judges”: allowing the creation of specialized courts, including the High Intellectual Property Court; and limiting representation before the courts to individuals licensed and admitted to practice law (“attorneys-at-laws”) in Ukraine.

The High Intellectual Property Court will act as the court of the first instance for IP-related disputes. Currently, the amendments contain only basic regulations of the specialized IP

court. Nevertheless, the reform is ongoing, and the majority of regulations are forthcoming. In particular, the government now works on the preparation of the new procedural code for this specialized court. It is anticipated that the specialized IP court would be formed by the end of this year or maybe in early 2018.

This is very exciting news, as finally, somebody in Ukrainian judiciary might start to understand gaming and software developing companies with their F2P, EULAs, open sources and proprietary codes, MSAs, SOWs, NDAs, gaming currencies, etc. And thus, the general court practice might become more industry friendly and predictable. The obvious downside in this process is, of course, is that companies would need to pay more attention to their legal homework, as this court will better understand their partners and software developers too.

**Good news, successful IP rights enforcement and resolution of IP disputes for gaming industry will get easier with establishment of a specialized IP court in Ukraine. Bad news, you will need a lawyer for that as well.**

## **It is impossible to do an IP reform without breaking an egg/ What happened?**

On August 23, 2016, the Cabinet of Ministers of Ukraine executed the first step of a reform in the sphere of intellectual property and adopted a decision to liquidate the State Intellectual Property Service (SIPS) and transfer all of its functions to the Ministry of Economic Development and Trade of Ukraine (MEDT). SIPS is the main government body responsible for the state's IP policy, trademark, patent and copyright protection, the functioning of respective IP registries, etc.

The liquidation decision did not take immediate effect and SIPS was finally liquidated only in the beginning of April 2017.

The government aimed by this reform to create a high quality, transparent and efficient system for intellectual property protection in Ukraine through the adoption of a special law and establishment of a National Agency for Intellectual Property.

Now, this reform has stuck in midair with SIPS being already liquidated and the draft law regulating the creation of a new agency not even being submitted to the Parliament for consideration.

Even though MEDT has automatically overtaken functions of SIPS with respect to supervision of trademark, patent and copyright registration, the creation of all internal routine related to this work might take some time, and not all functionality will be available.

Therefore, gaming companies might expect some difficulties with various procedures related to trademark, patent and copyright registration in Ukraine in the nearest 3-6 months.

**Watch out for unusual issues with your IP right registrations in Ukraine. The IP system is under construction, stay tuned!!!**

**April 2017**



**Sean Kane**



## **When It Comes to Games, The Practical Limit to United States Copyright Protection May Only Be Skin Deep**

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Copyright claims based on alleged similarities between video games (“clones”) are as old as the industry itself. While video games, like other creative works, may receive some level of protection, not all elements of a game are protectable. Abstract ideas, including game mechanics and rules, as well as functional and scenes a faire elements, are not entitled to copyright protection under current United States law. Only expressive elements are protectable. For courts, this distinction can sometimes be only skin deep, and whether or not a clone faces liability frequently turns on whether the second developer takes the time to create a new visual design for a game.

This article briefly reviews the US law behind game cloning and copyright law, and highlights the importance that visual design and aesthetics play in whether allegations of cloning translate into actual liability.

## I Rules for publishing game in Iran

The scope of copyright protection enjoyed by video games is narrower than many realize. As the Copyright Office has explained in stark terms: “[c]opyright does not protect the idea for a game, its name or title, or the method or methods for playing it. . . . Once a game has been made public, nothing in the copyright law prevents others from developing another game based on similar principles.” This is the much-discussed “idea-expression dichotomy,” and while it is an easy principle to state, it is much harder to consistently apply in practice.

Applying this theory to games, Courts have held a wide array of game features are entitled to little or no copyright protection, including:

- Instructions, including dialogue boxes, tool tips, game instructions and arrow indicators.
- Game Rules and Mechanics, including all of the “rules and procedures, including the winning procedures” that operate and animate gameplay.
- Game Board Design, such as the use of a six-by-six grid in a “match-three” puzzle game.
- Scoring or Point Systems, which track player performance, as well as the method of using points or coins to reward players and allow the purchase of power-ups.

Courts have also been unwilling to find copyright protection in common game tropes, so-called “scenes a faire” elements, which define certain types of genres. For example, when the owners of the iconic Dawn of the Dead film sued Capcom over its game, Dead Rising, a California federal court concluded that the movie and game setting – a suburban mall – and both work’s portrayal of characters using improvised weapons to fight zombies were unprotectable, generic elements of a zombie survival horror story. Other examples include basic martial arts moves in fighting games, or the stock fantasy trappings of “sword and sorcery” epic adventure, including wizards, elves and dwarves.

So what game elements can be protected by copyright? Often, courts focus on the most obvious creative aspects of a game — its visual appearance, and the unique aspects of a game’s characters. The visual design of a game, particularly where the game is abstract or fanciful, is protected. The design of even simple games, like Tetris, are eligible for protection: “the style, design, shape and movement of [Tetris] pieces are expression.” Similarly, other courts have held that the unique, progressive matching hierarchy in Triple Town, and the colorful design of Breakout are creative choices that enjoy copyright protection.

Characters are eligible for protection when they are uniquely recognizable, either because they are genuinely novel (like Pacman) or because a work takes stock characters and elevates them above the tropes of the genre to become icons, such as Chun Li, Ken and Lt. Guile from Street Fighter. And, once a character reaches that status, creative aspects of that character’s personality or appearance, like Lt. Guile’s unique “sonic boom” attack, are also entitled to protection.

## | A Tale of Two Clones

Two relatively recent cases reinforce the difference between copying unprotectable ideas and rules, and copying protected expression: Tetris Holdings, LLC v. Xio Interactive, Inc., 863 F.Supp.2d 394, 410 (D.N.J. 2012), and DaVinci Editrice S.R.L. v. Ziko Games, LLC, 183 F. Supp. 3d. 820 (S.D. Tex. 2016). While both cases involve arguably the wholesale appropriation of a preexisting game’s rules, the former also took the visual aesthetic and was likely infringing, whereas the latter re-skinned the game’s rules with a new theme and escaped liability.

*Tetris Holdings, LLC v. Xio Interactive, Inc.*

In Tetris, the developer of a game called Mino was alleged to have infringed Tetris by copying substantially all aspects of the famed puzzle game. In defending against Tetris's claim, Xio admitted to downloading a copy of Tetris and creating what amounted to a "clone" of the game, but claimed that it had taken steps to only copy the non-protectable elements of Tetris. These steps even included obtaining an opinion from legal counsel. Xio alleged it had not infringed Tetris because Mino only copied "rules, function and expression" which were "essential to the gameplay" but which did not constitute original protectable expression. In short, Xio relied on the argument that the rules of Tetris were inseparable from the expression, and so to the extent that the games looked alike, it was due to the fact they operated on the same rules.

The court rejected this argument out of hand, finding that Xio had done more than just incorporate Tetris' underlying rules. For the court, the fact that Xio had appropriated the visual design of Tetris was significant, and it spent significant time looking at the similarity of the look and feel of the two games, stating that "[t]here is such similarity between the visual expression of Tetris and Mino that it is akin to literal copying" regardless of the fact that Xio did not actually copy the underlying Tetris code. The court contrasted Mino with another Tetris-inspired game, Dr. Mario, to demonstrate how a developer can remix game concepts and ideas without appropriating protected visual elements. The court took pains to note that, in Mino, "the style of the pieces is nearly indistinguishable, both in their look and in the manner they move, rotate, fall, and behave. Similar bright colors are used in each program, the pieces are composed of individually delineated bricks, each brick is given an interior border to suggest texture, and shading and gradation of color are used in substantially similar ways to suggest light is being cast onto the pieces." The court described other problematic similarities between Tetris and Mino such as the game board dimensions, the manner in pieces are displayed, and the appearance of the completed game board. The Court found that the movements of the blocks in Tetris were not merely functional, but expressions associated with those elements.

*DaVinci Editrice S.R.L. v. Ziko Games, LLC*

DaVinci arose out of allegations that Ziko had cloned DaVinci's popular card game, Bang!, while only tweaking the game's aesthetic so that it took place in an ancient Chinese martial-arts setting instead of the Old West. The parties agreed that each game's rules were nearly identical, and much of the litigation focused on whether the allegedly unique characters in Bang! (the "Sheriff," "Deputy," "Outlaw" and "Renegade") were infringed by Ziko's versions ("Monarch," "Minister," "Rebel," and "Turncoat").

At the motion to dismiss stage, the court let DaVinci's claims survive, finding that the in-game characters' capabilities were part of their attributes and traits, and therefore could be protectable along with their names and visual design. Examining the "totality of the characters' attributes and traits," the court concluded a "reasonable factfinder" could conclude the games were similar, despite the fact that one was set in a Wild-West theme, whereas the other was set in ancient China.

Ultimately, however, Ziko prevailed at the summary judgment stage because it was able to show that the alleged infringement — the relationship among the various in-game characters — was a function of rules and not expressive narrative content. The court was swayed by the fact that Ziko's game had featured starkly different visual elements and character design, and different kinds of special powers (even if they did function identically within the rules of the game). Moreover, the court thought it significant that DaVinci's characters and special abilities were not connected to an overarching narrative, and had no set role or relationship in any play-through of the game. "Unlike a book or movie plot, the rules and procedures, including the winning conditions, that make up a card-game system of play do not themselves produce the artistic or literary content that is the hallmark of protectable expression . . . Instead, the game rules, procedures, and winning conditions create the environment for expression." Absent the appropriation of a defined character relationship, roughly analogous to a movie plot, the court was skeptical that there could be infringement.

In the end, the court found that the special abilities did not create expressive, protected character interaction, writing that "[t]he events in a Bang! game are not predetermined because the interactions between the roles have no underlying script or detail and are not fixed. Making certain roles aligned with and others opposed is part of the game's winning conditions, but these determine little about how players progress through the game." And, as a result, the court dismissed the case and granted judgment in favor of Ziko.

# | Takeaway

Beyond highlighting the weight that courts give to visual elements and character design, these cases hold lessons for developers looking to ensure that their works are protected, and for others looking to capitalize on a genre growing in popularity. For the former, it's not enough to develop an innovative new set of rules for a game. If a game is to enjoy robust copyright protection, those rules must be connected with expressive, creative visual elements and strong developed characters that set the game apart from those that might follow-on. For second-mover developers, it is important not to cut corners and not take the time to create an independent visual aesthetic that sets a game apart from the earlier games that inspired it. Indeed, building on the court's comments in Tetris, it is better to take inspiration from games like Dr. Mario and combine new designs and new gameplay elements rather than lean entirely on a re-skin of what has come before.

**April 2017**



# Code Ownership is a Trap

**Gregory Boyd**



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# | The Wise Ones Propagate the Myth

One of the third whiskey pieces of advice I hear “sophisticated” game developers giving young people at conferences is to make sure you “own your code” when you finally get a development deal. Ownership of the code is entirely unimportant and it will often be used as a weapon against developers to trade much more valuable rights. Think of it as simple misdirection, the modestly elevated progeny of a “your shoe is untied” type of distraction. When a publisher has you looking away, they might pick your pocket.

First off, we should admit that developers have less leverage in negotiations than funders. A funder can be an outside investor, traditional publisher, or newer publishing platform that may provide development funds. For the purposes of this short essay, I will refer to all of those as “publishers” and also for this short essay, the leverage difference is always in mind. I am not proposing developers ask for things they would never receive. Developers may be able to receive some or all of items discussed here or else it would not be worth writing about. Most importantly, for this article, developers should stop focusing on what is unimportant or simplistic and keep their eye on what really matters around ownership.

Second, a very brief note on how copyright functions. Copyright is the main protection for game code. One person can “own” the copyright in the code and other rights or subrights relating to ownership can be licensed out to other parties. In the law and in this article, the person that owns the rights and is licensing them out is referred to as “the Licensor” and the person receiving the rights is referred to as “the Licensee.”

# | The True Nature of Ownership

As noted above, legally, ownership in code is controlled through copyright. In law school copyright is referred to as a bundle of sticks. How many sticks are in the bundle? There is an infinite number of sticks in the bundle.

This is one of the truly wonderful and meaningful areas of the law where mathematics, philosophy, and psychology land hard in reality to actually affect every game development deal. Just like in the real world, you do not have to be aware of the speed of sound, earth's gravitational constant, or behavioral economics. You can be entirely ignorant of those and they still affect your everyday life. The process works automatically and with a cold efficiency wholly indifferent on your awareness of the rules. The same is true for copyright in game development and its bundle of sticks. With focus and attention you can build something or get ignorantly bludgeoned to death with that bundle of sticks.

What are the sticks? The sticks are all the different ways ownership can be divided. In this little article we will just talk about three of the most important ones. After you know about these, you can start to imagine other sticks in the bundle – and what you can do with them.

## **| Ownership – Control – Cash**

### **Copyright Ownership**

When people think about ownership, the “trap” part is one of the sticks, but not the whole bundle. Plain vanilla copyright ownership in the code is important, but not by itself, and it is not the most important stick in the bundle. The development agreement should include who owns the copyright in the code itself. Preferably, this should be just one party to the agreement. Co-ownership gets messy because in the United States that means that each party can fully and separately exploit the code without accounting for revenue to the other party. Keep in mind, just because a party may not “own” the code, this means very little. For instance, you can be a mere licensee of the code and still (1) have a copy of the code; (2) re-use the code; or (3) make improvements or derivative works (sequels) using the code; or even (4) re-sell, publish, or sublicense the code. All of the things above are little “sticks” in the bundle of copyright that can be licensed out. So, of the three items discussed in this article, Ownership, Control, and Cash Flow – ownership alone is the least important. I would give the publisher copyright ownership of the code every time if the developer gets the correct license rights including the items above and some of the other elements of control and cash flow discussed below.

## **Control**

One of the key sticks in the bundle of ownership is Control and even that has many elements. For the purposes of this article, we can consider three control elements: credit, translation, and sequels.

Who gets credit for making the game, creating the idea, and how is that credit displayed to the world? Many developers have learned the hard way that a publisher can have a larger, longer, and more prominent splash screen on a game opening. Furthermore, one of the people at the publisher could be anointed with a “Director” or “Creative Director” or even “Co-Creator” title. This has to be set out right from the start of the agreement, or the world will never know the truth about who made your game. Furthermore, titles are not empty appellations. If someone at the publisher becomes the Director of your game, you may lose power and final authority over creative decisions. While it might not be obvious at start how credit is related to control, the reality of the relationship is not something that should sneak up on a developer.

Consider translations and localizations of the game, who controls that, who selects the people to do it, who pays for it, and what visibility does the developer have into those costs? Localization is often ignored, but critical to a game’s success. Besides being expensive and complicated, these studios doing the work are your ambassadors to that part of the world. Their translations, feel for the game, and other subtle cultural changes are the difference between success and failure for a title. This is a key element of control and not a decision to make on cost alone.

Sequels are the most clearly felt pain for developers that fall into the simplistic trap of code ownership. One of fundamental rights of telling your own story is having control over how and if to continue that story. Many developers have thoughtlessly given that up. Where possible, make certain the developer has control over how sequels are told. The developer should have creative direction. The developer should have a first right of refusal on developing the sequel. If the developer wants a sequel, but chooses to not develop it themselves, for economic or other reasons, they should have approval over who continues the story. Perhaps they also maintain certain creative input or veto power over story elements. All of this can only be negotiated in advance in development deal. Without a prior explicit agreement, the publisher will usually have these rights by default.

## Cash Flow

The flow of money is also more important than code ownership. Understanding cash flow requires understanding what goes into it and how exactly it is calculated. First, there is the royalty. This is often stated as 10% or 20% or [X]% of certain dollars to developer (or publisher). That is only the start of the story. If you get 20%, then ask 20% of what and how is it calculated? Is it gross dollars? Not likely. OK, then it is some form of net dollars. Now listen very carefully. Really. I'm not kidding. Maybe I'll put it right in the middle of a page by itself so you don't sleep through it like everything else.

THERE IS NO STANDARD DEFINITION OF NET REVENUE!

I hope you heard that. There may be a publisher's "way of doing things." Those are always designed to benefit the publisher. There may also be some things that the accounting department adds or subtracts that are difficult to change. None of that matters at the end of the day. Now is your chance to fix it. If there is something that goes on "automatically," then we will account for it here. How much is automatically deducted? 2%? OK then, the developer will just take 2% more of net.

If there is ever some discretionary wiggle room in a net revenue calculation, do not accept a publisher's argument that "it is not in our interest to take advantage of you here." When a developer sees that, then the appropriate response is to say "any deductions not explicitly in the definition of Net Revenue must be prior approved by developer." If it is reasonable, the developer will approve it. If not, then perhaps it should come out of the publisher's portion. Net revenue in the games industry is not a dumping ground of Hollywood Accounting where publishers should be encouraged or allowed to toss in every cost. We owe it to each other as **professionals in the space to anticipate costs and agree on what should be a deduction. There are so many cases where games have the opportunity to rebuild on the mistakes of traditional media. Net revenue is one of those places, but it takes a daily vigilance because the lazy, thoughtless way moves the ball toward traditional media's dumping ground of Hollywood Accounting (which truthfully is not good for either party).**

Keep in mind that if a publisher gets 80% and the developer gets 20%, then 80% is the fair payment for the publisher doing “their job” and any deduction from net revenue is tacitly an agreement that this is at least partly a “developer job.” Net revenue affects developers disproportionately. They are much more cash flow constrained than publishers. Though it is not mathematically or economically entirely accurate, it is instructive to consider that a developer is taking out a loan against future revenue to pay for any net revenue deduction. Whenever a developer gets stuck in a net revenue negotiation, the right question to ask is always – which party fairly has responsibility for this cost? What does the publisher’s 80% pay for? Maybe marketing should be included as a publisher internal cost, not a net revenue deduction. If the developer is paying for “everything” in the net revenue definition that means the 80% publisher split is meant to be internal publisher operating costs plus profit. Is that fair and does it mean the percentages should be moved to account for it?

Keep in mind, that if a developer cannot get the net revenue “wins,” then it should feel empowered to re-visit the split to account for any inequity. Conceding internal accounting process issues in the net revenue definition is fine, but do not leave the fundamental fairness issue unaddressed. Account for it by changing the royalty split.

Now is the time to ask questions and probe deeply. This is the honeymoon period. It is the nicest a publisher will ever be to a developer. Ask so many questions and get them to lay out so much of the important things on paper that they won’t have wiggle room later. This is the entire point of the contract process. Assume that there are large and important elements missing from the contract and make certain those are written out and explicitly addressed. Here it is important say that developers should not chase unicorns or invent specters either. Your attorney will help you understand what the differences are between real and imagined risks.

How publishers treat you now is a sign of what is to come. Are they totally honest now? Do they treat you like you are smart now? Are they forthcoming on internal processes? Do they seem internally organized and able to speak with one voice? Most publishers are risk-averse and disorganized entities that act a bit like super-organisms. Everyone is doing the best they can with the information they have. Everyone that talks to a developer will overstate their authority a bit.

It isn't malicious. It is human nature. Still, we have to get it in writing or it won't matter. Ask people questions. Ask them questions repeatedly. Get them to commit by putting it into the contract. For instance, if they assure you that you will be involved and have final approval over advertising spend, then put it in the contract. If it is not in the contract, it is not real.

Put in a sample calculation. If we are all friendly and the omniscient publisher does this all the time then we won't have any problem just putting it all right down here. There is no real reason a publisher cannot put in a sample royalty calculation based on real numbers with real deductions and talk through various scenarios with the developer. Insist on it.

Consider this sample calculation. Net Revenue equals Gross dollars minus what? Maybe platform fees, license fees, discretionary costs not listed? These definitions can go on for 5 or six lines of text in a real contract. Know what every one of them means and insist on seeing their effect in a sample calculation.

What about advertising? What about internal costs? What about other "soft costs" or costs at their discretion?

Keep in mind that Net Revenue means one thing in practice. What is the developer paying for? It is the developer's account. The publisher is loaning you money against future revenue. Still, if advertising or marketing is deducted that means that the developer is paying for advertising or at least sharing in those costs. Do you have control over the creative, over the spend amount, over the placement? If you don't, is it fair for you to pay for it?

Invoicing and quarterly reports are another place developers can lose money. Today, the standard is real time same account access to numbers. In the past, publishers were able to generate reports on sales and give developers the reports. That made sense because we were dealing with a lot of retail partners worldwide. The standards were set in a pre-internet, pre-social media era. Technology was not as advanced as it is now. Today, we have multiple tracked login access and real-time reporting on everything that matters. That is the standard and put in the agreement that this is how the developer will receive reporting and how the developer will be paid.

Auditing is important. Even if you never use it, you want to have the right to use it. Make sure you list exactly what you can audit. If you have the right to audit something you often don't have to audit it. In a low level dispute, you can write an email and say, our agreement says we could just audit X. So, why don't you give it to us? Then, people are much more forthcoming with providing X. So, think about everything you might want access to in the agreement, especially if you are not able to get real-time account access to all revenue streams.

Consider who gets paid first. This was not a choice at the start of the games industry or even in the first 10 years of this century. Players used to pay retailers and publishers first every time. Now, a developer can insist on having the primary platform accounts for Steam, Apple, Android, etc. in their full control. Clearly with the larger platforms like Xbox and PlayStation the publishers and the platforms will get paid first. Remember that the large publishers are not the only way to do it. The best possible way to calculate royalties and net revenue is to calculate it yourself. There are few things in life more satisfying than writing out a check to your publisher in this context. There are many developers that send publishers money every quarter now – but only if they were thoughtful enough to ask for it in their development agreement.

## **| Now You Know and They Cannot Fool**

In most development agreements publishers allow developers to “own” their code. The developers are very pleased with themselves and go to sleep each night feeling they won their negotiation. In truth, they often give away all or substantially all of everything discussed here including crediting, sequel control, and worst of all real monetary participation. When I was a much younger attorney, this was described to me by venerated “old timer” publisher attorneys this way. “Sure, Developer, you can pee anywhere you want. I just have to hold it for you.” This is terrible on so many levels. It is vulgar, oppressive, and assumes the developer is a man. The statement itself is not nearly as bad as the reality and the effects of that reality on the unsuspecting developer. Maybe we have a chance to do a little better in the coming years.

A final final word, that upon reflection will go on a bit longer than it should. You should always seek the advice of your own attorney. Every situation is different. I wrote this to help you,

knowing full well that one day you (developer) will likely use it against me when I am on the publisher side. That does not mean you will win. Whitman and I have anticipated this:

Do I contradict myself? Very well then, I contradict myself. I am large and contain multitudes. I wish the intractable hell on all of you – of having the publisher and developer literally yelling at you on a conference call, quoting things you have written as evidence for their position. Then, in the same moment, you will truly live and wish you hadn't. Further, I assure you all of your good deeds will be properly punished.

Knowing the rules of the game elevates the discussion and this is my intent. It is immoral and largely no fun to beat up on the ignorant. Economic realities and the myriad contextual elements of the deal will dictate who prevails on any individual point. It is my hope that writing something like this, teaching classes, and gods-save-me-from-ever-doing-it-again WHOLE BOOKS on the subject will let all the parties go into these agreements with their eyes open. It is one thing to “fool” an ignorant developer. I would rather not have that as a standard in the industry going forward. I would rather have it that each side knows we are talking about an infinite bundle of sticks, considers and accepts positions deliberately, with an understanding of the consequences.

It is about the art at the end of the day. We have to feed ourselves and our children, but we cannot forget that it is (or should be) about the art. No matter where we sit at the table, we all choose to be here. I hope there was more to that choice than just making money because there are easier ways to do it. Be honest with each other. Commit to doing what we say we are going to do. Show that commitment by writing it out in the contract. It isn't “the paperwork,” it is the very foundation of THE WORK. Literally every choice in the contract comes down to building the game. Take it seriously. For each choice, is this going to make the game better? Is this better than not having the game made or having it made on a shoestring budget? Are these the people you want to work with? Is this going to be more of your or less of vision? Is it something you can feel good about, including how you treated the people involved? Is this a day well spent or a compromise?

**March 2017**



# China Legal Update

## Greg Pilarowski



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**PILLAR LEGAL**

**LEGAL PRIMER: REGULATION OF CHINA'S DIGITAL GAME INDUSTRY**

**April 2017**

This memorandum is provided by Pillar Legal, P.C. (the “Firm”) as a service to clients and other readers. Special thanks is also due to Niko Partners, a market research firm specializing in China’s game industry, who assisted in the preparation of this memorandum. The information contained in this publication should not be construed as legal advice, and use of this memorandum does not create an attorney-client relationship between the reader and the Firm. In addition, the information has not been updated since the date first set forth above and may be required to be updated or customized for particular facts and circumstances. This memorandum may be considered “Attorney Advertising” under applicable state laws. Questions regarding the matters discussed in this publication may be directed to the Firm at the following contact details: [www.pillarlegalpc.com](http://www.pillarlegalpc.com), +1-925-474-3258 (San Francisco Bay Area), +86-21-5876-0206 (Shanghai), email: [greg@pillarlegalpc.com](mailto:greg@pillarlegalpc.com). Niko Partners website: [www.nikopartners.com](http://www.nikopartners.com). Section 3 (Overview of China’s Game Market) © 2017 Niko Partners; all other Sections © 2017 Pillar Legal, P.C.

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## LIST OF TERMS

“Domestic company” refers to a company established under the laws of the PRC with only PRC citizens or other domestic companies as shareholders.

“Domestic game” refers to a game that is owned by a domestic company.

“E-sports” refers to organized multiplayer online game competitions.

“Foreign company” refers to a company established under the laws of a jurisdiction other than the PRC.

“Foreign game” refers to a game that is owned by a foreign company or a foreign-invested company.

“Foreign-invested company” refers to a company established under the laws of the PRC with at least some non-PRC citizens or foreign companies as shareholders. Foreign-invested companies can be in the form of a wholly foreign owned entity or in the form of a joint venture.

“Internet” or “Online” refers to the internet or an online activity that takes place through the internet, irrespective of whether the internet is accessed through, or that online activity takes place through, a personal computer (PC), a mobile phone or another device.

“Internet café” refers to retail outlets where customers can rent the use of an online PC.

“Mobile game” refers to an online game that is designed to be played primarily on a mobile phone or other mobile device.

“Online game” refers to a game product or service that is accessible through the internet. As used in this memorandum, online game includes both PC online games and mobile games.

“Online game operator” refers to a company that digitally distributes online games, which digital distribution generally includes matters such as hosting the game servers, promoting the game and handling customer service.

“PC online game” refers to an online game that is designed to be played primarily on a personal computer.

“PRC” refers to the People’s Republic of China, excluding for the purposes of this memorandum Hong Kong, Macao and Taiwan.

## 1. INTRODUCTION

This is the fourth edition of our “Legal Primer: Regulation of China’s Digital Game Industry”. This regulation and policy bulletin, like previous versions, provides an overview of the legal environment and the actual regulatory practice for the digital game industry in the People’s Republic of China (the “PRC” or “China”).

The focus upon law as well as practice is a deliberate choice that is influenced by the nature of the legal system in mainland China. As readers who have lived and worked in China are well aware, the position of law within society is very modest in China when compared with the position of law in the societies of developed Western democracies. In China, law does not generally constrain the lawmaker and often only represents a statement of a lawmaker’s policy position at a particular point in time.

Accordingly, an overview of any area of law in mainland China should not stop with a summary of the current rules as set forth on the books. The inquiry should go one step further to examine the current practice in the field. This second step is, however, more of a journalistic endeavor than traditional legal research. It is important to speak with the regulators, as well as employees tasked with legal compliance and government relations at companies in the industry. In China’s digital game sector, which is primarily comprised of online businesses, it is also possible to check compliance with various regulations by visiting the websites and mobile apps of leading game operators, mobile app stores and developers. Awareness of how past situations have been handled can also help clarify the otherwise traditionally vague language of China’s regulations and the sometimes unstated policies that lie behind those regulations.

As a result of our focus on both law and practice, this bulletin includes the summaries of written rules that the reader would expect, but also includes informal comments from regulators based upon our interviews, impressions from industry participants and a regulation compliance scorecard that provides a snapshot view of what rules are being followed, and which ones are being ignored. Since the first edition, which was released in July 2010, the content has expanded and our compliance scorecard data has grown with each new edition.

Before discussing the detailed regulations on the books, this bulletin first provides a brief overview of the key factors that shape the scope of China’s online game market, including the high levels of software piracy and prior prohibition on game consoles such as the Xbox and PlayStation. As a result of these factors, China’s game market is essentially an online game market, and this primer therefore focuses primarily upon the regulation of online games. This preliminary section also explains China’s policy of prohibiting foreign (meaning non-PRC) companies from operating online games in China, as well as the variable interest entity structure used by domestic (meaning PRC) companies to evade these restrictions in order to obtain foreign capital and list their shares on foreign stock exchanges.

In recognition of China’s powerful governmental authorities, before discussing any specific laws, we first introduce the two primary regulators of the game industry – the Ministry of Culture (文化部) (“MOC”) and the State Administration of Press, Publication,

Radio, Film and Television (新闻出版广电总局) (“SAPPRFT”).<sup>1</sup> In the past, these regulators have clashed in their attempts to assert a dominant role in regulating this very lucrative industry, which is an important fact to consider when interpreting rules issued by MOC or SAPPRFT.

The first set of rules we discuss are those for the various approvals that must be obtained for each game prior to commercial launch within China. Because (i) foreign game companies are the primary readers of this bulletin, (ii) such foreign game companies are not legally permitted to directly operate PC online games in China, and (iii) there are substantial barriers that restrict foreign companies from directly operating mobile games in China, the game approval rules are those that are of greatest relevance to most readers. We also discuss how the approval rules applicable to domestic online games differ from those applicable to foreign games.

We then turn to the regulations applicable to the operation of online games in China, including the three required licenses, as well as several general rules such as those relating to the anti-fatigue system, real-name registration and virtual currencies. Although these rules do not directly affect foreign game companies because they are not permitted to directly operate online games in China, the information contained in these sections is helpful for those readers interested in a comprehensive overview of the game industry’s regulatory framework.

Finally we summarize the rules regarding internet cafés, traditionally a primary venue for online game players in China, e-sports, live online streaming and various government tax and incentive measures that relate to the online game industry.

## **2. SCOPE OF CHINA’S GAME MARKET**

### **2.1. Piracy Challenge and Prior Game Console Prohibition**

In many jurisdictions, including the United States and Europe, console games have historically dominated the game market. In mainland China, however, historic prohibitions against the sale of game consoles, the relatively high costs of the consoles and rampant piracy have all contributed to the dominance of online games over console games in China’s game market.

Beginning in 2000 and continuing until 2014, the sale of game consoles was officially prohibited in China. In June 2000, the State Council (国务院) issued the Notice on Launching a Campaign against Video Arcades, which prohibited the manufacture and sale of both coin operated arcade game machines and television console game machines.<sup>2</sup> Although

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<sup>1</sup> In March 2013, the State Administration of Press, Publication, Radio, Film and Television (新闻出版广电总局) (“SAPPRFT”) was created through the merger of the former General Administration of Press and Publication (新闻出版总署) (“GAPP”), and the former State Administration of Radio, Film and Television (国家广播电影电视总局) (“SARFT”). SAPPRFT as used in this bulletin refers to the government authority that resulted from the merger, as well as to GAPP and SARFT separately for periods prior to the merger.

<sup>2</sup> See Article 6 of the Notice on Launching a Special Campaign against Illegal Electronic Game Rooms (国务院办公厅转发文化部等部门关于开展电子游戏经营场所专项治理意见的通知), issued by the General Office of the State Council on June 15, 2000. It is worth noting this notice from the State Council was not fully implemented with respect to arcade games. For example, Article 3.3 of the Shanghai Electronic Game Rooms Management Test Work Plan (上海电子游戏经营场所管理试点工作方案), issued by Shanghai Municipal Administration of Culture, Radio, Film and TV on May 23, 2006, indicates that existing electronic game rooms may replace and purchase new electronic game machines based upon their

the stated purpose of the notice was to regulate video arcades in order to protect the youth and ensure public order, the notice was drafted broadly and became the primary legal barrier to the importation, manufacture and sale of game consoles such as the Xbox, PlayStation and Wii.

Notwithstanding such prohibition, game consoles were generally available for purchase in underground markets in China's major cities during the game console ban. Nevertheless, the vast majority of consumers in China were priced out of purchasing game consoles because the prices for such game consoles were often significantly higher in China than in the United States and Europe, and, coupled with the cost of a television, naturally involved a much greater upfront investment by each such consumer in comparison to the low hourly costs of playing online games at internet cafés.

In 2014, the State Council officially ended the game console ban.<sup>3</sup> Currently, if game consoles are manufactured in mainland China and pass inspection by the Ministry of Culture (文化部), then those game consoles can be legally sold throughout China. Although the game console ban ended three years ago, the market for game consoles and their software remains small.<sup>4</sup>

Moreover, the relatively high rate of software piracy in China is an additional factor that shapes the scope of the country's domestic game market. According to a study by the Business Software Alliance, an industry association, China's software piracy rate in 2015 was 70%, which is higher than both the global average of 39% and the Asia Pacific average of 61%.<sup>5</sup> Pirated software is readily available in China, both as an optional add-on when purchasing a new computer or game console and on a standalone basis. In addition, the improvement in broadband speed has facilitated the spread of online access to pirated software. According to the 2016 China Gaming Industry Report, console and single-player PC games only accounted for 0.4% and 0.1%, respectively, of the total game market revenue in China in 2016,<sup>6</sup> which suggests that there is no material legal market in China for the console and traditional single-player PC games that are sold in the U.S. and elsewhere as packaged goods software. Our suspicion, however, is that such metrics might not include data regarding single-player PC games that players downloaded or purchased through Valve Corporation's ("Valve") Steam or Tencent Holdings Limited's ("Tencent") WeGame

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actual needs. On its face, this clause directly contradicts the prohibition on the sale of electronic game machines contained in Article 6 of the State Council notice. In addition, coin operated arcade game machines are readily available throughout China.

<sup>3</sup> See Article 31 and 32 of the Annex of the Decision of the State Council on Temporarily Adjusting Relevant Administrative Regulations and Administrative Approval or Special Administrative Measures on Foreign Investment Access in China (Shanghai) Pilot Free Trade Zone (国务院关于在中国（上海）自由贸易试验区内暂时调整有关行政法规和国务院文件规定的行政审批或者准入特别管理措施的决定), issued by the State Council on January 6, 2014, and see Article 22 of the Annex of the Notice of the State Council on Promoting the Replicable Experience from the Pilot Reform in China (Shanghai) Pilot Free Trade Zone (国务院关于推广中国（上海）自由贸易试验区可复制改革试点经验的通知), issued by the State Council on December 21, 2014.

<sup>4</sup> For a discussion of the potential impact of the end to China's game console ban, see "[Game Consoles Trade Ban Lifted: Will a New Market Emerge?](#)" by Greg Pilarowski at Insights, a publication of The American Chamber of Commerce in Shanghai, posted on April 18, 2014.

<sup>5</sup> See "[Seizing Opportunity through License Compliance](#)", posted at [globalstudy.bsa.org](http://globalstudy.bsa.org) in May 2016.

<sup>6</sup> See Page 12 of the 2016 China Gaming Industry Report (中国游戏产业报告), posted at Game Industry (游戏产业网) on December 12, 2016.

(formally called the “Tencent Game Platform” or “TGP”), each of which are online game distribution platforms.

In part due to the prior ban on game consoles and the high cost of consoles and software piracy rates, China’s game market is dominated by online games, which we define to include traditional PC online games as well as mobile games. PC online games together with mobile games account for over eighty percent (80%) of digital game revenues in China,<sup>7</sup> and also represent one of the leading internet applications in the market by revenue.

## **2.2. Foreign Ownership Restrictions**

Although online games, which we defined to include both PC online games and mobile games, have dominated China’s game market, according to the rules as written on the books, foreign companies are not permitted to directly publish or operate online games in China. As a result, the only legally permitted way for foreign game developers to enter China’s domestic game market is by licensing their games to domestic companies for publication and operation inside China. As discussed in more detail in Section 6.5 (Self-Publishing Mobile Games in China) below, in practice foreign companies are currently able to publish and operate mobile games in China through the Apple App Store, though this small opening for self-publication might change at some point.

The prohibition on foreign companies, which includes foreign-invested companies, meaning companies established under the laws of the PRC with at least some non-PRC citizens or foreign companies as shareholders, from operating online games is not unusual for China. In fact, the country’s entire corporate legal regime is based upon this very clear distinction between domestic companies and foreign-invested companies, with detailed rules indicating which segments of the economy are open or closed for each type of company. For the purpose of foreign investment restrictions, China’s entire economy is divided into four categories: encouraged, permitted, restricted and prohibited.<sup>8</sup>

The online game operation business, as opposed to the online game development business, like most internet related businesses, is regarded as a part of the telecommunications industry, which is an area where foreign investment is restricted.<sup>9</sup> Although there are some limited exceptions for businesses established inside the Shanghai pilot free trade zone, foreign investment in the telecommunication industry must generally take the form of an equity joint venture with the foreign ownership interest not exceeding 50%.<sup>10</sup> The online game operation business is, however, also regarded as an internet cultural activity and a form of online publishing service, both of which fall into the prohibited

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<sup>7</sup> See Page 12 of the 2016 China Gaming Industry Report (中国游戏产业报告), posted at Game Industry (游戏产业网) on December 12, 2016.

<sup>8</sup> See the Foreign Investment Catalogue (Amended in 2015) (外商投资产业指导目录(2015 修订)), issued by the State Council on March 10, 2015.

<sup>9</sup> See Article V, Section 7 of the Catalogue of Restricted Foreign Investment Industries, in the Foreign Investment Catalogue.

<sup>10</sup> See the Decisions of the MIIT on Further Opening of Value-Added Telecommunications Service in (Shanghai) Pilot Free Trade Zone (关于中国（上海）自由贸易试验区进一步对外开放增值电信业务的意见), issued by the MIIT on January 6, 2014.

category where foreign investment is not allowed.<sup>11</sup> As a result, foreign investment in an online game operation business is not permitted in any form.

In practice, this prohibition is carried out through a licensing regime. As noted in Section 6 (Game Operation and Publication Licenses) below, the rules as written on the books require each operator of online games in China to obtain three licenses, including the internet culture operation license issued by MOC and the online publishing service license issued by SAPPRFT.<sup>12</sup> Neither MOC nor SAPPRFT will issue these licenses to foreign or foreign-invested companies, which effectively protects China's online game operation market from foreign competition, in particular the PC online game operation market as further explained in Section 6.5 (Self-Publishing Mobile Games in China). In January 2017, the State Council issued a notice that implied China might gradually remove or reduce some foreign investment restrictions, including the restrictions or prohibitions on telecom, internet and culture industries.<sup>13</sup> There have not, however, been any detailed regulations or measures that suggest China is planning to open its online game operation industry to foreign competition.

Notwithstanding these foreign investment restrictions, many companies in China that operate in restricted or prohibited industries have received financing from foreign venture capital funds and have listed their shares on overseas stock exchanges.<sup>14</sup> Such companies have achieved what they believe to be technical compliance with the foreign ownership restrictions by establishing a variable interest entity (“VIE”) structure in which the foreign-invested entity does not have a direct ownership interest in the domestic company that holds the licenses required to operate in the restricted or prohibited industry. A detailed discussion of the VIE structure, including a diagram and descriptions of the primary contracts used to create the structure, is set forth in Annex II.

### 3. OVERVIEW OF CHINA'S GAME MARKET<sup>15</sup>

2016 was another year of growth for the digital games market in China, inclusive of PC online games, mobile games, and TV based games or console games. The PC online games segment remains the largest and most important segment of the market but it is the mobile games segment that is driving growth. The console games segment is still the smallest segment in China's market, as China is a predominately PC- and mobile-based gaming culture. The value of China's total digital games market exceeded US\$24 billion in 2016, up 17% year over year, which makes it larger than the U.S. digital games market. In addition, China's market accounts for roughly half of global PC online game revenue.

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<sup>11</sup> See Article X, Section 31 of the Catalogue of Prohibited Foreign Investment Industries, in the Foreign Investment Catalogue (Amended in 2015).

<sup>12</sup> The relevant regulatory authorities are not currently enforcing the operating license requirements with respect to mobile game developers that self-publish their games through the mobile app stores in China. The rules as written do not, however, draw a distinction between PC online game operation and mobile game operation, with the various licenses technically being required to operate any online game whether mobile or PC.

<sup>13</sup> See Article 1, Section 2 of the Notice of the State Council on Several Measures concerning the Expansion of Opening-up and the Active Use of Foreign Capital (国务院关于印发扩大对外开放积极利用外资若干措施的通知), issued by the State Council on January 12, 2017.

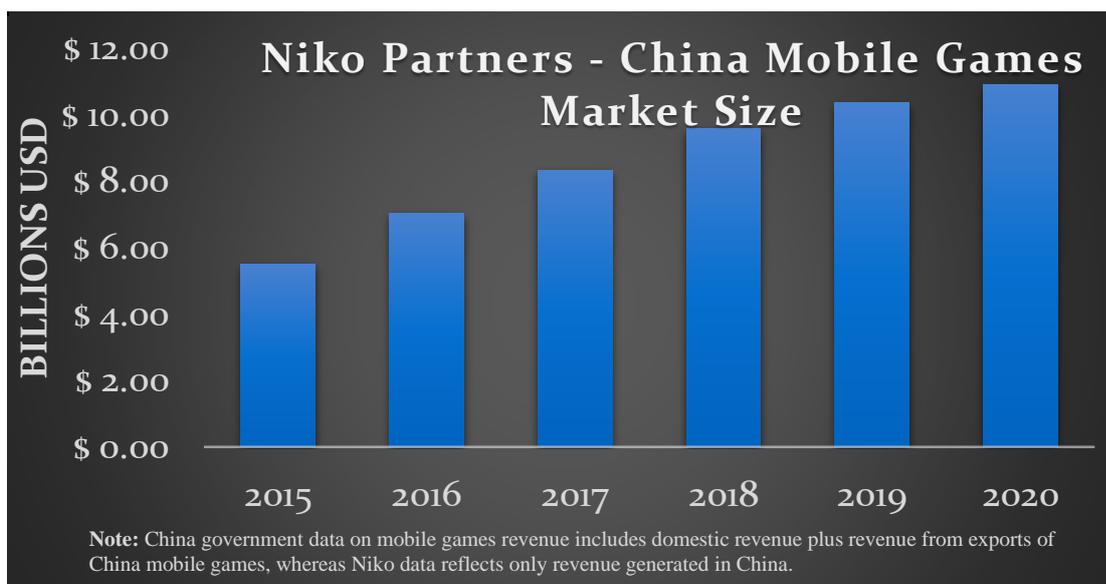
<sup>14</sup> Online game companies in China with shares listed on overseas stock exchanges include: Tencent Holdings Limited, Changyou.com Limited, and NetEase, Inc.

<sup>15</sup> Special thanks is due to Niko Partners, a market research firm specializing in China's game industry, who prepared this market overview section of the memorandum.

In recent years mobile game revenue has enjoyed a steep upward growth curve, as the growth rate for PC online games has slowed. The evolution of e-sports, however, has breathed life into the PC online games segment causing the decline to be buffered and revenue to pour back into these games. Gamers throughout China flock to play and watch professional competitive e-sports tournaments, where gamers play PC (and increasingly mobile, too) games for money and other prizes. This primary driver of growth for the PC online games market overall has also led to an increase in the use of internet cafés, online video sites, and amateur gamers playing the leading e-sports titles, such as Tencent’s League of Legends, Perfect World’s Defense of the Ancients 2 (Dota 2), and Blizzard’s Overwatch. In fact, there are approximately 150,000 internet cafés in China with an average of 20 million customers per day – nearly all of whom are playing e-sports games or watching e-sports tournaments online.

There were nearly 300 million PC online game players by the end of 2016 in China with growth being led by client-based massively multiplayer online games (“MMOG”). Within client-based games, multiplayer online battle arena (“MOBA”) and first-person shooter (“FPS”) genres are dominant in terms of revenue and usage. Historically, massively multiplayer online role-playing games (“MMORPG”) have been quite important in China as well. Other segments within PC online games, such as web games and casual games, have seen a decline in revenue this year as these titles have moved away from the PC platform and found a new home on mobile. Free to Play (“F2P”) remains the most widely used and most successful monetization model in the PC online games segment but we have noticed a resurgence in demand for paid standalone (single-player, offline) games this year due to the growing popularity of PC game distribution platforms such as Valve’s Steam, Tencent’s WeGame, GOG Galaxy and more.

The mobile games segment grew 19% year over year in 2016. We believe that market revenue growth for mobile games peaked in 2014 but the segment is still the primary driver of growth in the China games market. Niko Partners forecasts the 5-year compound annual growth rate for mobile games from 2015 to 2020 to be 14.7%.



Source: Niko Partners 2017

There are more than 80,000 mobile game developers vying for a piece of China's mobile games demand, with hundreds of Android app markets (though approximately 20 are considered "important") serving nearly 500 million mobile gamers. Casual games are still the most popular genre on mobile as they are easily accessible to all. It is more core genres such as role-playing game ("RPGs"), MOBAs, FPS and strategy titles, however, that dominate the top grossing game charts. As discussed in more detail elsewhere in this legal primer, the biggest change to the mobile game market in 2016 was the introduction of the Notice Regarding the Administration of Mobile Game Publication Services (关于移动游戏出版服务管理的规定) issued by SAPPRFT on May 24, 2017, which signaled the intention to enforce with respect to mobile games the longstanding requirements that all games must be approved by SAPPRFT before being published in China. Previously, SAPPRFT did not vigorously enforce this requirement with respect to mobile games.

The TV-based game or console game market consists of 9.2 million gamers, most of whom play on grey market consoles, followed by smart TVs or Android TV boxes, with the fewest number playing on legal consoles. The console market in China is still new as it was only in 2014 that China's government overturned a 14-year ban on the official sale of game consoles in the country. Since then, Microsoft's Xbox One launched in China in September 2014 and Sony's PlayStation 4 launched in China in March 2015. Sales of consoles have been slow in China, hindered by the harsh regulatory environment and price sensitive gaming culture. For example, the Sony PS4 hardware launched at RMB2,899 (around US\$470) and an average of RMB275 (US\$40) for a single game. The average annual salary in China, as of 2014, was around RMB56,360 (US\$8,655). To buy the console and one or two games consumes an entire month's wages for the average PRC citizen.

We are cautiously optimistic about the long-term growth of the console game market as companies such as Sony launch new initiatives to lower the price of their console and introduce more mid-core and hard-core game titles that appeal to PRC gamers.

The games market in China is also being driven by new technologies and areas such as virtual reality ("VR"), augmented reality ("AR") and e-sports. 2016 became "year one" of virtual reality in China, since the sector finally truly started to grow. We estimate that China's VR hardware market size hit US\$300 million in 2016 with far more demand for mobile VR headsets compared to the pricier PC-based or console-based VR hardware. VR games have not yet drawn the attention of mainstream consumers, and developers are trying to catch up to the demand for VR gear. Meanwhile, VR cafés and experience zones throughout China allow gamers to try VR without the investment in high-end hardware, seeding consumer demand for the future.

E-sports are becoming more popular than ever in China. 2016 saw the introduction of an official e-sports degree in colleges by China's Ministry of Education (教育部) and we expect to see more companies investing in e-sports and tournaments this year. Mobile e-sports will see huge growth this year driven by core titles like King of Glory (王者荣耀) and casual titles like Battle of Balls (球球大作战), both of which are being played by 75 million users per day. The number of e-sports enthusiasts who are fans of professional e-sports exceeded 100 million as of the end of 2016.

Augmented reality was a hit in 2016 with titles such as Pokémon GO becoming a global sensation. The game utilized AR and location-based services ("LBS") in a fun,

Pokémon collecting experience. SAPPRFT is currently considering whether Pokémon GO and other AR/LBS games can be safely distributed, given the threat they might pose to national security and personal safety – but these games are banned for now pending the outcome of the ongoing investigation.<sup>16</sup> Notwithstanding the ban, game developers in China have been quick to implement similar technology into their games. For example, NetEase’s Onmyoji (阴阳师) allows you to import characters into the game using augmented reality. If the regulators allow AR/LBS game elements, perhaps subject to specific compliance rules, we are likely to see more games embrace aspects of AR and LBS functionality going forward.

Tencent is currently the dominant company in the China digital game industry with a 43% share of total game revenues. The company’s market capitalization was US\$250 billion as of the end of 2016, 2016 revenue was US\$21.9 billion, and the portion of that derived from digital games rose 25% in 2016 to US\$10.3 billion. The company has developed and published hit mobile games, such as King of Glory (王者荣耀), which was the number one top grossing mobile game in China during 2016. The technology company has seen continued growth through its dominance in social networks such as WeChat and by investing in and acquiring profitable game developers over the years. Tencent is now the owner of Riot Games, the developer of League of Legends, and last year the company acquired 84% of Supercell in a deal worth US\$8.6 billion. They’ve also acquired stakes in Activision Blizzard, Glu Mobile, Robot Entertainment, Epic Games and more.

One of the biggest concerns for game market executives previously has been how they can compete in a market so heavily dominated by a single company. Companies like NetEase, Perfect World, 37 Interactive and others have shown in 2016 that it is possible to compete in this market. App Annie’s latest list of the top mobile publishers in 2016 showcases Tencent rising to number one globally, however ten of the top 52 publishers hail from China and have grown despite the competitive market – NetEase, Elex Technology, IGG, Perfect World, Happy Elements, Snail Games, Baidu, Kunlun and Longtech Network.

As of the end of 2016, NetEase had a 20% share in the games market after focusing on bringing its long maintained and high quality game franchises to the mobile platform. In addition, NetEase has focused on developing new IP in growing genres as well as partnering with foreign developers to bring more games to China. Some basic background regarding China’s leading online game publishers, including Tencent and NetEase, are set forth in [Annex III-A](#) (Online Game Publisher Pages).

The China digital games market remains vibrant with lots of growth potential across all three segments, PC online games, mobile games and even TV-based games or console games.

#### **4. THE REGULATORS**

The online game industry, like many segments of China’s economy, is subject to numerous regulations issued by various administrative authorities, including each of the following:

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<sup>16</sup> See [“Regulator Suspend Game Approval: AR Game is coming to a ‘cross road’”](#) (监管部门暂不受理审批：AR 游戏走向“十字路口”) (Chinese), posted at Tencent Tech on January 12, 2017.

- (1) Ministry of Culture (文化部);
- (2) State Administration of Press, Publication, Radio, Film and Television (新闻出版广电总局);<sup>17</sup>
- (3) State Council (国务院);
- (4) Cyberspace Administrative of China (国家互联网信息办公室) (“CAC”);
- (5) Ministry of Industry and Information Technology (工业和信息化部) (“MIIT”);
- (6) Ministry of Public Security (公安部) (“MPS”); and
- (7) National Copyright Administration of the People’s Republic of China (中华人民共和国国家版权局) (“NCAC”).

#### **4.1 Introduction of Regulators**

The primary regulators of China’s online game market are MOC and SAPPRFT, together with their local offices. In addition to MOC and SAPPRFT, however, many other administrative authorities play a role in online game regulation, including the State Council, CAC, which is the primary regulator for nationwide cyberspace information content management, MIIT, which is the primary regulator of the telecommunications industry, MPS, which is the main police force in China, and NCAC.

Although MOC and SAPPRFT are the primary regulators for China’s online game industry, their powers and responsibilities are not clearly defined and the two authorities have frequently clashed when attempting to assert regulatory control over the lucrative digital game industry. Some regulatory actions, such as the anti-fatigue rules issued by SAPPRFT in 2007 and the virtual currency rules released by MOC in 2009, are easier to understand when viewed in this competing regulator context.

In July 2008, in connection with a larger restructuring of the central government, the State Council attempted to clarify the regulatory authority of MOC and SAPPRFT with respect to the online game industry.<sup>18</sup> Pursuant to the various regulations issued in connection with this restructuring, MOC became the primary regulator for the online game industry, but SAPPRFT retained pre-publication approval authority over online games.<sup>19</sup> As illustrated by the World of Warcraft story described below, the issuance of these regulations by the State

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<sup>17</sup> SAPPRFT was created in March 2013 through the merger of the former General Administration of Press and Publication (新闻出版总署), and the former State Administration of Radio, Film and Television (国家广播电影电视总局). SAPPRFT as used in this bulletin refers to the government authority that resulted from the merger, as well as to GAPP and SARFT separately for periods prior to the merger.

<sup>18</sup> See the Regulation on the Responsibilities, Internal Structure and Personnel of MOC (文化部主要职责内设机构和人员编制规定), issued by the General Office of the State Council on July 10, 2008 (the “MOC Three Determinations Regulation”) and the Regulation on the Responsibilities, Internal Structure and Personnel of SAPPRFT, or SAPPRFT Three Determination Regulation (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), issued by the General Office of the State Council on July 11, 2008 (the “SAPPRFT Three Determinations Regulation”).

<sup>19</sup> See Article 1, Section 3 of the MOC Three Determinations Regulation and Article I, Section 2.1 of the SAPPRFT Three Determinations Regulation.

Council did not resolve the issue of regulatory authority with respect to the online game industry.

MOC's interpretation of SAPPRFT's pre-publication approval authority for online games, as confirmed during our informal interviews with MOC personnel, is that this authority is limited to the elements of the game distributed in physical form, such as CDs and DVDs.<sup>20</sup> Accordingly, MOC argues that SAPPRFT's approval authority will diminish as use of physical media decreases and more games are distributed exclusively in digital format over the internet without the use of any client side software provided on physical discs.<sup>21</sup>

SAPPRFT, however, interprets its approval authority broadly, extending not only to publication in physical form but also to online publication in purely digital form.<sup>22</sup> In addition, SAPPRFT believes that its approval is required whenever there is any change to the content of a previously approved game and whenever the domestic online game operator for a foreign game is switched from one operator to another.<sup>23</sup> This position, however, appears to conflict with the statement from a circular issued by the State Commission Office for Public Sector Reform (中央机构编制委员会) ("SCOPSR") that once a game is available online MOC shall assume full regulatory authority, as further described below.

Notwithstanding the contradictory position of MOC and SAPPRFT regarding their respective regulatory authority, the text of the various Three Determination Regulations, the actual resolution of the World of Warcraft relaunch approval discussed below, and actual practice in recent years, all indicate that both MOC and SAPPRFT continue to have significant regulatory authority over the industry. Accordingly, most game companies work hard to maintain positive relations with both MOC and SAPPRFT, regarding each authority as a primary regulator for the industry.

CAC, which was established in May 2011, is a sub-department supervised by the State Council Information Office (国务院新闻办公室), and since 2014, CAC has governed national internet information content.<sup>24</sup> CAC also works very closely with the Office of Central Leading Group for Cyber Affairs (中共中央网络信息化领导小组) ("OCLGCA"), an organization established in 2014 that is under the direct leadership of the Communist Party of China. Currently, the leader and various officers of CAC and OCLGCA are the same people.<sup>25</sup> OCLGCA is also a very an important organization within the Communist Party of

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<sup>20</sup> See "[State Commission Office for Public Sector Reform Clarifies Management Responsibility for Online Games](#)" (中央编办明确网游管理职责) (Chinese), posted at the MOC website on September 28, 2009.

<sup>21</sup> See the MOC summary notice entitled State Commission Office for Public Sector Reform Clarifies Management Responsibility for Online Games.

<sup>22</sup> See Section 2 of the Notice on Implementing the Three Determinations Regulations of State Council and Related Interpretation, and Further Strengthening the Approval Work on Online Games Publication and Importation (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), issued by SAPPRFT on September 28, 2009.

<sup>23</sup> See Section 5 of the Notice on Implementing the Three Determinations Regulations of State Council and Related Interpretation, and Further Strengthening the Approval Work on Online Games Publication and Importation.

<sup>24</sup> See the Notice of Authorizing the Cyberspace Administration of China to Administrate National Internet Information Content (关于授权国家互联网信息办公室负责互联网信息内容管理工作的通知), issued by State Council on August 26, 2014.

<sup>25</sup> Source: [CAC website](#).

China, and President Xi Jinping, the current leader of the Communist Party of China, served as the first chief of OCLGCA. Probably due to the high profile of OCLGCA and its close ties with CAC, CAC has exercised widespread censorship control over the internet in recent years. Although most of the regulations issued by CAC do not specifically target the online game industry, CAC regulations do affect China's online game industry.

Annex I attached hereto sets forth organizational charts for State Council, MOC, SAPPRFT and MIIT, indicating their respective positions within the central government of China, and noting the key department within each regulator that is tasked with overseeing the online game industry.

#### **4.2 World of Warcraft: Caught Between Two Regulators<sup>26</sup>**

In the spring of 2009, Activision Blizzard and NetEase inadvertently provided MOC and SAPPRFT with an opportunity to assert their regulatory power over the digital game industry when they jointly announced the execution of a new mainland China license for the World of Warcraft, pursuant to which one of the leading foreign online games would move from the original domestic operator (The9) to a new domestic operator (NetEase). A brief summary of the World of Warcraft transition story helps to illustrate the struggle between MOC and SAPPRFT.

Notwithstanding the fact that World of Warcraft had been operated in China for four years at the time Activision Blizzard and NetEase announced the new license, shortly after that announcement, both MOC and SAPPRFT indicated that the game would need to apply for a new approval, undergoing another content censorship review, prior to the commencement of commercial operation by the new domestic operator.<sup>27</sup> Although there was no rational basis to require a second round of censorship for a game with four years of operating history inside the country, the requirement for a new censorship review of any foreign game when transferring from one domestic operator to another is now the law in China.

On July 21, 2009, MOC reapproved World of Warcraft for commercial operation. By mid-September, three months after the term of the original license ended and commercial operation of the game ceased, SAPPRFT had not yet reapproved the game.

In September 2009, the SCOPSR, the central government department charged with interpreting the Three Determinations Regulation of various governmental offices, issued a circular interpreting the Three Determinations Regulation as it relates to MOC and SAPPRFT.<sup>28</sup> This circular reiterated that MOC is the primary regulator of the online game

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<sup>26</sup> For additional background information on the MOC – SAPPRFT conflict and the World of Warcraft transition story in China, please see the following articles by Greg Pilarowski at The Escapist: “[China and the World of Warcraft](#)”, posted on August 16, 2009, and “[Mind the GAPP: Update on WoW in China](#).”, posted on November 6, 2009.

<sup>27</sup> See Article 3 of the Notice on Standardizing the Application and Review Work for Imported Online Games (关于规范进口网络游戏产品内容审查申报工作的公告), issued by MOC on April 24, 2009, and Article 2 of the Notice on Implementing the Three Determinations Regulations and the Reform Commission Interpretation and Strengthening the Preapproval of Online Games and Administration of Imported Online Games (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), issued by the General Administration of Press and Publication in September 2009.

<sup>28</sup> See the State Commission Office for Public Sector Reform's Interpretation of the Provisions Concerning Animation, Online Game and Law Enforcement in the Cultural Market in GAPP, MOC and SARFT Three Determinations Regulation

industry, while also restating that SAPPRFT shall be responsible for the approval of games prior to their publication. Once a game is available online, however, MOC shall assume full regulatory authority.

One interpretation of this circular is that SAPPRFT's approval was not required for the commercial relaunch of World of Warcraft since the game had previously been available online and thus should fall under the regulatory authority of MOC. On September 19, 2009, apparently in reliance upon this interpretation, NetEase relaunched World of Warcraft without having first received the approval of SAPPRFT. On November 2, 2009, however, SAPPRFT declared the relaunch of the game illegal and demanded a halt to its commercial operation. Nonetheless, on February 12, 2010, SAPPRFT approved the commercial relaunch of World of Warcraft, apparently after NetEase reached a negotiated settlement with SAPPRFT that included issuing a self-criticism for its prior actions.

From a rule perspective, the primary outcome of the World of Warcraft transition is a new requirement for another round of censorship review whenever a foreign game moves from one domestic operator to another. From a policy perspective, however, the core lesson is that both MOC and SAPPRFT regard themselves as a key regulator for China's online game industry and both are determined to defend their authority even if it results in erroneous regulations, public inter-agency disputes, economic losses to industry participants and suspension of service for game players. As noted above, domestic game companies generally work hard to maintain positive relations with both MOC and SAPPRFT, even though MOC is assigned the primary regulatory role for the industry pursuant to the various Three Determination Regulations.

## **5. GAME APPROVALS**

China's media content industries, including those that publish news as well as those that produce entertainment products, are subject to comprehensive government censorship regimes. In the digital game industry, every game must be approved by SAPPRFT prior to commercialization. In addition, each foreign game must be reviewed and approved by MOC prior to commercialization, and each domestic game must register with MOC within 30 days after becoming available online. This section provides an overview of China's content review, approval and registration process for foreign and domestic games. Additional details with respect to these procedures for both foreign and domestic online games are set forth in Annex IV.

### **5.1 Game Content and Functionality Restrictions**

China has promulgated a variety of measures relating to internet content, which includes online games. These regulations are drafted in broad general terms and prohibit content that:

- (1) Opposes the fundamental principles determined in the constitution;
- (2) Endangers the unity, sovereignty or territorial integrity of the nation;

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(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), issued by the State Commission Office for Public Sector Reform in July 2009.

- (3) Divulges state secrets, endangers national security, or damages the dignity or interests of the nation;
- (4) Incites ethnic hatred or racial discrimination or undermines national solidarity, or infringes upon national customs and habits;
- (5) Propagates evil cults or superstition;
- (6) Disseminates rumors, disrupts social order or undermines social stability;
- (7) Propagates obscenity, pornography, gambling, violence or instigates crimes;
- (8) Insults or slanders others, or otherwise infringes upon the legitimate rights of others;
- (9) Endangers social morality or national splendid cultural traditions; or
- (10) Is otherwise prohibited by the laws, or administrative regulations of the PRC.<sup>29</sup>

In addition, an online publication marketed to minors may not contain any content that induces such minors to imitate acts or content that are against social morality, are criminal, or are horrible or cruel in a way that impairs the physical and mental health of minors.<sup>30</sup> Moreover, as mentioned above, Pokémon GO and other AR/LBS games are currently banned by SAPPRFT. SAPPRFT has indicated that AR/LBS games might endanger national security and personal safety, and is therefore conducting an investigation into AR/LBS games, and prior to the release of the outcome of such investigation, SAPPRFT will not accept game approval applications in connection with AR/LBS games.<sup>31</sup>

Prior to May 2016, no governmental authority had publicly explained the actual meaning and scope of the various general content censorship provisions listed above. On May 24, 2016, after SAPPRFT had issued rules indicated that each mobile game must be approved by SAPPRFT before such game can be published online, the China Audio-Video and Digital Publishing Association (中国音像与数字出版协会), an organization that is affiliated with SAPPRFT, issued the Specification of Mobile Game Content (2016 Edition) (移动游戏内容规范 (2016年版)) (the “Mobile Game Content Guidance”). The Mobile Game Content Guidance provides additional guidance with respect to the general content restrictions in the context of mobile game censorship approvals. Although the Mobile Game Content Guidance on its face applies only to mobile games, the standards found in the Mobile Game Content Guidance should also be considered in the context of censorship approvals for PC online games or any other category of game.

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<sup>29</sup> See, among others, Article 17 of the Interim Provisions on Internet Publication Administration, Article 16 of the Interim Provisions on the Administration of Internet Culture (互联网文化管理暂行规定) issued by MOC on May 10, 2003, and amended on February 17, 2011, Article 9 of the Interim Provisions on the Administration of Online Games (网络游戏管理暂行办法), issued by MOC in June 2010, and Article 15 of the Internet Information Services Administrative Measures (互联网信息服务管理办法), issued by the State Council on September 25, 2000.

<sup>30</sup> See Article 16 of the Interim Provisions on the Administration of Online Games.

<sup>31</sup> See “[Regulator Suspend Game Approval: AR Game is coming to a ‘cross road’](#)” (监管部门暂不受理审批：AR 游戏走向“十字路口”) (Chinese), posted at Tencent Tech on January 12, 2017.

MOC has also developed internal standards for game content review, including materials that MOC uses to train certified game censors that domestic game companies are required to employ, which materials we have reviewed. When comparing the censorship standards of the two regulators, SAPRRFT generally applies stricter standards than MOC. For example, SAPRRFT requires that all text in mobile games be in simplified Chinese characters and no foreign language text is allowed to appear.<sup>32</sup> Commonly used English language game terms, like “HP” for example, which is an abbreviation of the English term “Health Point,” are not allowed. In an MOC training for internal censors of domestic companies, however, MOC has specifically indicated that there is no such requirement to avoid using foreign language terms in online games.<sup>33</sup> Our informal translations of the content restriction standards set forth in the Mobile Game Content Guidance and MOC’s internal content censorship training materials are listed in Annex V-A, along with some specific real world examples to provide further insight into the meanings of such content restriction standards.

In addition to visible content, the authorities also regulate certain aspects of game functionality. The internal content censorship training materials from MOC contain a list of game functionality restrictions, which include a prohibition on in-game gambling features. Although the laws of China include an absolute ban on gambling both offline and online, such laws do not define the term “gambling”. Based on the relevant rules and our conversations with various industry participants, however, when determining whether or not an online game includes “gambling” functions, the regulators generally follow the rules described below.

- (1) No Treasure Box Features. Online games must not include treasure box features. A “treasure box feature” is a game feature that randomly allocates virtual currency or virtual items based on the outcome of a lottery style function that requires payment of legal currency, purchased virtual currency or purchased virtual items to participate.<sup>34</sup> Treasure box features were an important monetization tool for games through which players sometimes received valuable in-game items, but more often received nothing.<sup>35</sup> Although the legal currency and purchased virtual currency treasure box feature was banned, some game operators continue to include treasure box features, but the keys for such boxes are purchased with earned virtual currency, not purchased virtual currency, thereby avoiding the ban.<sup>36</sup> According to our informal communication with MOC staffs, MOC allows the online game has treasure box features that players could participate with earned virtual currency, even if such earned virtual currency is purchased with purchased virtual currency.
- (2) No In-Game Player to Player Virtual Currency Transfers. Online games may not include a function that enables one player to transfer virtual currency to another

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<sup>32</sup> See Article 4 of the Specification of Mobile Game Content (2016 Edition) (移动游戏内容规范 (2016年版)) issued by CDPA on May 24, 2016 (the “Mobile Game Content Guidance”), and “UPDATE: New Mobile Game publishing regulations in China”, posted at zhugeex.com on July 11, 2016.

<sup>33</sup> See “Regarding the Recent Hot Shop of Online Game Censorship, See What MOC Says” (关于网游审批的近期热点, 来看看文化部又是怎么说的) (Chinese), posted at gameres.com on July 8, 2016.

<sup>34</sup> See Article 3 of the Virtual Currency Notice.

<sup>35</sup> See page 21 of Giant’s annual report on Form 20-F for the year ended December 31, 2011 at the SEC website.

<sup>36</sup> See page 61 of Shanda Games’ annual report on Form 20-F for the year ended December 31, 2011 at the SEC website.

player within the game. The transfer of earned virtual currency among game players is also prohibited by the Mobile Game Content Guidance.<sup>37</sup> In this context, we understand “transfer” to mean a direct voluntary transfer from one player to another that is not the result of an in-game contest between those players. As a result, this prohibition does not prevent a transfer of virtual currency from a losing player to a winning player after an in-game match.

Although in-game voluntary virtual currency transfers are prohibited, secondary markets for virtual currency sale and purchase do exist in China. By using these secondary markets to agree on the sale of virtual currency, and then to deliver the virtual currency to the buyer by deliberately losing a match to the buyer in-game, players do have a mechanism to sell their accumulated in-game virtual currency winnings. Although this activity is a prohibited gambling activity, the regulators have not yet enacted rules that would eliminate the practice, such as requiring in-game matches to be among randomly selected players rather than permitting players to choose their own match opponents.

- (3) Bet Limits and Daily Loss Limits. A match bet function in an online game is not a “gambling” feature, provided that this function includes upper limits for the amount a player can bet in each match and the amount a player can lose in a single day.<sup>38</sup> Although the rules themselves don’t include actual numbers for these limits, our market checks suggest a maximum bet limit from RMB20 to RMB80 of purchased virtual currency is common. During our informal calls with MOC staff, we learned that MOC’s preference is that the maximum amount an individual player can lose in one day does not exceed RMB500 of purchased virtual currency. If bets are placed with earned virtual currency, as opposed to purchased virtual currency, our market checks suggest that so long as there is some kind of daily loss limit and max bet limit per match, even if those limits are very high, that should be acceptable.
- (4) Type of Virtual Currency Used to Bet. Our market checks indicate that both purchased virtual currency and earned virtual currency are currently used to bet within games. The use of purchased virtual currency to place bets involves higher risk as this is more likely to be deemed illegal gambling than when earned virtual currency is used. Nonetheless, purchased virtual currency is often used to bet within games, especially for majiang or poker games. Some companies, however, use a more complicated mechanism. They create a special virtual item that can only be bought by using purchased virtual currency. This virtual item can then only be used within the poker game or other social casino style game, and cannot be redeemed or exchanged back into purchased virtual currency. Various market players are apparently of the view that this additional step, which puts additional distance between the betting currency and the purchased virtual currency, reduces the risk of the in-game betting function being deemed an illegal gambling.
- (5) Contingent Fees. Game publishers should not charge players a per match fee based on whether or not the players win or lose the match (e.g. no fee if a player loses the

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<sup>37</sup> See Section 12.2.6 of the Mobile Game Content Guidance.

<sup>38</sup> See Section 12.2.4 of the Mobile Game Content Guidance.

match, but a winning player must pay a fee).<sup>39</sup> Our market checks indicate that game publishers can, however, charge a fixed fee per match from each player irrespective of whether the players win or lose the match.

Additional details and our informal translations of the online game functionality restrictions of MOC's internal content censorship training materials are set forth in Annex V-B.

## 5.2 SAPPRFT Game Approval Process

Before a digital publication, which includes PC online games and mobile games, can be published in China, the product must first be reviewed and approved by SAPPRFT.<sup>40</sup> For PC online games, based on our informal discussions with SAPPRFT and industry participants, it is clear that the same SAPPRFT pre-publication review and approval procedures apply equally to both foreign games and domestic games. In the context of mobile games, however, “simple domestic mobile games”, which is a specifically defined category (as further discussed below), are subject to a less stringent content censorship approval procedure. All other mobile games, including both foreign and domestic mobile games, are subject to the same SAPPRFT pre-publication review and approval procedure to which PC online games are subject.

During the early stages of growth of the mobile game sector in China, SAPPRFT did not enforce the game approval process with respect to mobile games. On May 24, 2016, however, SAPPRFT issued the Notice Regarding the Administration of Mobile Game Publication Services (关于移动游戏出版服务管理的规定), which indicates that SAPPRFT intends to start enforcing the long standing game censorship approval requirements with respect to mobile games (the “Mobile Game Approval Notice”). Prior to release of these rules, neither SAPPRFT nor MOC had actively enforced the game censorship approval requirements for mobile games, which has resulted in very low compliance rates with these approval requirements for mobile games relative to other categories of games, such as PC online games.<sup>41</sup>

In the Mobile Game Approval Notice, SAPPRFT adopts a less stringent content censorship approval procedure for simple domestic mobile games, which is a new category of mobile games established by SAPPRFT. Domestic online games (all domestic PC online game and domestic mobile game that do not fall within the new category of mobile games), as well as foreign online games, remain subject to the SAPPRFT game approval process that existed before issuance of the Mobile Game Approval Notice.

A simple domestic mobile game is a mobile game that does not contain any materials relating to political, military, ethnic or religious topics and is a “simple” non-story based game, such as a matching game (消除类), obstacle course or running game (酷跑类), flying

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<sup>39</sup> See Section 12.2.3 of the Mobile Game Content Guidance.

<sup>40</sup> See Article 5 of the Administrative Provisions on the Publishing of Electronic Publications (电子出版物出版管理规定), issued by SAPPRFT on February 21, 2008.

<sup>41</sup> Based on compliance checks conducted by Pillar Legal in April 2014, of the top ten games on the top five mobile app stores in China, only 8% complied with the SAPPRFT game approval requirements and only 22% complied with the MOC game approval requirements.

game (飞行类), poker or board game (棋牌类), puzzle game (解谜类), sports game (体育类), or music or dance game (音乐舞蹈类).<sup>42</sup> Additional details regarding SAPPRFT's game approval procedures, including the relevant procedures for a simple domestic mobile game, are set forth in Annex IV.

Once SAPPRFT approves a PC online game for publication, the publication number must be displayed in a prominent place on such PC online game's website.<sup>43</sup> For a mobile game, the names of such mobile game's copyright owner and publisher, the SAPPRFT game censorship approval number, and the publication number for such mobile game must be displayed prior to any end user interactive experience.<sup>44</sup> If a company wishes to publish any upgraded version or expansion of either an approved PC online game or an approved mobile game, a new application for such upgraded version or expansion must be submitted to SAPPRFT.<sup>45</sup> In the Mobile Game Approval Notice, SAPPRFT explains that upgraded versions and expansions of a mobile game include material changes to the game's storyline, the content of quests, the game's maps, the game's characters, the features of the game's characters or interaction functions, and adding a subtitle directly after the original name of such mobile game, each of which requires approval by SAPPRFT in the same way as if it was a new game.<sup>46</sup> Although the Mobile Game Approval Notice applies on its face only to mobile games, the standards of determining what constitutes a new game found in the Mobile Game Approval Notice should also be considered in the context of PC online games or any other category of game.

In addition, according to the Mobile Game Approval Notice, SAPPRFT required all non-SAPPRFT-approved mobile games that were available on the market to either obtain approval from SAPPRFT by October 1, 2016 or be removed from the market.<sup>47</sup> Although SAPPRFT has since extended the deadline to December 31, 2016, given the large volume of mobile games available in China, the historically low mobile game approval compliance rates and the limited staff resources at SAPPRFT, a long backlog of pending mobile game applications with SAPPRFT now exists, which could lead to material delays in obtaining the required approvals.

SAPPRFT requires a "joint-operator" of a mobile game to verify that the mobile game has completed the SAPPRFT application and censorship approval process and posted the required disclosure within the game.<sup>48</sup> Although SAPPRFT does not clearly define the term "joint-operator", based on our informal discussions with SAPPRFT staff, we understand that the mobile app stores are considered to be joint operators. As a result, SAPPRFT is enlisting

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<sup>42</sup> See Article 3 of the Notice Regarding the Administration of Mobile Game Publication Services (关于移动游戏出版服务管理的规定), issued by SAPPRFT on May 24, 2016 (the "Mobile Game Approval Notice").

<sup>43</sup> See Article 27 of the Administrative Provisions on the Publishing of Electronic Publications and the game approval letter issued by SAPPRFT.

<sup>44</sup> See Article 8 of the Mobile Game Approval Notice.

<sup>45</sup> See Article 28 of the Administrative Provisions on the Publishing of Electronic Publications, and Article 6 of the Mobile Game Approval Notice.

<sup>46</sup> See Article 6 of the Mobile Game Approval Notice.

<sup>47</sup> See Article 14 of the Mobile Game Approval Notice.

<sup>48</sup> See Article 9 of the Mobile Game Approval Notice.

the help of the mobile app stores to ensure that all mobile games in their stores have completed the application and censorship approval process.

One interesting question this “joint-operator” requirement raises is whether Apple, Inc. (“Apple”), which operates its mobile app store in China without any of the required operating licenses,<sup>49</sup> would help SAPPRFT enforce the relevant game approval and censorship requirements. That question was answered in July 2016 when Apple issued a notice to their iOS game developers indicating that the developers would be required to comply with the Mobile Game Approval Notice.<sup>50</sup> Apple’s enforcement of SAPPRFT’s mobile game approval requirements, however, may only apply to domestic mobile game developers. Based on discussions with foreign mobile game developers, we understand that although Apple requests foreign mobile game developers to submit publication numbers provided by SAPPRFT after obtaining the relevant mobile game approval, foreign mobile game developers can choose to ignore such requests and publish their mobile games on China’s Apple App Store without submitting the publication number.<sup>51</sup>

Importantly, the SAPPRFT mobile game approval can only be submitted by an online publishing service provider (网络出版服务单位), which is an entity that holds an online publishing service license (网络出版服务许可证) issued by SAPPRFT.<sup>52</sup> Based on informal discussions with SAPPRFT and industry participants, it is clear that SAPPRFT game approvals for PC online games can also only be submitted by an online publishing service provider. Since SAPPRFT does not accept applications for the online publishing service license from foreign companies or foreign-invested companies,<sup>53</sup> a foreign company or a foreign-invested company cannot directly and in their own name submit online games, whether or not PC online games or mobile games, to SPARRFT for censorship review in connection with a game approval application.

### 5.3 MOC Game Approval Process

All foreign online games imported for operation within China must be submitted to the main office of MOC in Beijing for pre-publication content censorship review.<sup>54</sup> In addition, before being submitted to MOC, the game must first be reviewed by government trained and certified content censors employed by the domestic online game operator that

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<sup>49</sup> To operate a mobile app store in China, a company generally needs to hold an internet culture license issued by MOC and an internet publishing license issued by SAPPRFT, neither of which can be held by a foreign company or foreign-invested company, such as Apple or its PRC subsidiaries and investee companies.

<sup>50</sup> See “[Mobile Games Need Government Approval before Publishing on Apple’s App Store in China](#)”, posted at Gamegyro.com on July 1, 2016.

<sup>51</sup> On April 13, 2017, we checked compliance by several new mobile games recommended to users in the China Apple App Store. We discovered that most of these recommended new games were published by foreign companies without obtaining the SAPPRFT game approvals, including MouseBot published on April 3, 2017, Family Tumber published on April 5, 2017 and Ring Tower published on April 5, 2017.

<sup>52</sup> See Article 2 of the Mobile Game Approval Notice.

<sup>53</sup> See Article 10 of Administrative Provisions on Online Publishing Service

<sup>54</sup> See Article 1 of the Notice on Strengthening the Content Censorship of Online Games (文化部关于加强网络游戏产品内容审查工作的通知), issued by MOC on May 14, 2004.

intends to operate the game.<sup>55</sup> When submitting a foreign game to MOC for review and approval, the domestic online game operator that imports such foreign game must submit its own certified content censorship report, along with a content censorship application that includes, among other things, samples of the game software, the complete in-game text script and the game license agreement.<sup>56</sup>

Based on informal interviews with MOC staff, we understand that the Internet Culture Division (网络文化处) of the Department of Cultural Market is the division that is tasked with processing foreign game approvals, and that this division has a limited number of staff members. MOC does, however, invite industry experts such as university professors to assist with the foreign game review process.<sup>57</sup> MOC has established a list of such experts from which MOC chooses individuals to constitute a review committee. Each member of the committee examines the relevant materials with respect to games under review and provides a score rating, and then MOC makes a final decision with respect to each foreign game application according to a predetermined score rating system.<sup>58</sup>

Generally, a foreign online game cannot be operated and made available to the public in China before obtaining MOC pre-publication approval.<sup>59</sup> MOC has indicated, however, that a foreign game can be made available to the public for testing prior to obtaining MOC's approval if there is no advertising or marketing for the game, and if user accounts for the game are limited to no more than 20,000. As a result, a limited amount of beta testing can occur prior to obtaining formal MOC game approval.

As mentioned above, prior to submitting a foreign online game for MOC pre-publication approval review, the domestic operator must first review the game.<sup>60</sup> Government trained and certified censors that are employed by game operators must review games and submit signed reports to MOC with respect to each game that they review, together with the application for pre-publication review for a foreign game.<sup>61</sup> Once a foreign game has been approved, the approval number or filing number issued by MOC must be posted on the webpage for the approved game.<sup>62</sup> In addition, after a game has been approved, any

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<sup>55</sup> See Notice of the Ministry of Culture on Implementing the Administrative Measures for the Content Self-Examination of Internet Culture Business Entities (文化部关于实施《网络文化经营单位内容自审管理办法》的通知), issued by MOC on August 12, 2013 (the “[Self-Examination Measures](#)”).

<sup>56</sup> See Article 11 of the Interim Provisions on the Administration of Online Games.

<sup>57</sup> In the MOC internal content censorship training materials, there is research report from Central China Normal University regarding the game content censorship standard for violence.

<sup>58</sup> See Article 15 of the Tentative Measures for Administration of Internet Culture (互联网文化管理暂行规定), issued by MOC on March 21, 2011. Although the detailed organization of the expert committee referred to in these rules is not disclosed, both MOC staff and this Article 15 make reference to the expert review committee.

<sup>59</sup> See Article 10 of the Interim Provisions on the Administration of Online Games.

<sup>60</sup> See the Self-Examination Measures.

<sup>61</sup> See Article 5, 7 and 8 of the Self-Examination Measures.

<sup>62</sup> See Article 12 of the Interim Provisions on the Administration of Online Games.

expansion pack, new version or update that substantially changes the content of the game must be submitted to MOC for content censorship review.<sup>63</sup>

Like SAPPRFT, MOC will not accept applications for pre-publication review of online games from foreign companies due to the prohibitions preventing foreign companies or foreign-invested companies from directly operating online games in China. Based on our informal discussions with MOC and industry participants, applications for MOC approval of foreign online games must be submitted by an internet culture entity (互联网文化单位), which is an entity that holds an internet culture operation license (互联网文化经营许可证) issued by MOC.<sup>64</sup> Pursuant to the current rules on the books, each foreign online game must be licensed to a single domestic operator that holds an internet culture operation license on an exclusive basis,<sup>65</sup> and such domestic operator shall be responsible for submitting the relevant application to MOC for censorship approval. In addition, MOC shall review the applicable license agreement between the relevant foreign game company and domestic operator. As discussed in greater detail below, however, this supposed requirement for foreign companies to license their online games to domestic companies is currently not always followed in practice in connection with mobile games, and foreign mobile game developers seem to be able to publish and operate their mobile games through China's Apple App Store without licensing the games to domestic operators.

In contrast to the above-described procedure for foreign online games, domestic online games are not required to be reviewed and approved by MOC prior to operation within China. Domestic games are, however, subject to the same general rules that govern internet content. In addition, domestic games must be reviewed by the online game operator's government trained and certified content censors, and the domestic games along with the self-censorship report must be registered with MOC within 30 days after they are available to the public.<sup>66</sup> The game's MOC registration number must be displayed on the domestic game's homepage.

Notwithstanding the different procedures with respect to foreign and domestic online games, the various MOC regulations do not provide definitions for foreign online games and domestic online games. MOC has indicated, however, that a domestic online game is an online game whose copyright is owned by a domestic company. Online games that are owned by foreign companies, or foreign-invested companies that are incorporated in China, are deemed to be foreign online games that are subject to pre-publication censorship review by MOC.

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<sup>63</sup> See Article 14 of the Interim Provisions on the Administration of Online Games, and Article 4 of the Announcement of the General Office of the Ministry of Culture Regulating the Declaration of Content Examination of Imported Online Game Products (文化部办公厅关于进口网络游戏产品内容审查申报工作的公告), issued by MOC on April 24, 2009 .

<sup>64</sup> See Article 2 of the Mobile Game Approval Notice.

<sup>65</sup> See Article 12 of the Interim Provisions on the Administration of Online Games.

<sup>66</sup> See Article 13 of the Interim Provisions on the Administration of Online Games.

## 5.4 Game Copyright Registration

Although copyright registration is not required in order to benefit from copyright protection in China,<sup>67</sup> by registering a copyright with NCAC, the registrant obtains prima facie evidence of copyright ownership. In addition, obtaining a copyright registration for an online game is an essential step toward completing the required game approvals.

SAPPRFT requires a publisher of a domestic online game to submit a certificate of copyright registration of such game.<sup>68</sup> For a foreign online game, the relevant game license agreement shall be registered with NCAC, and the certificate of game license agreement registration received from NCAC shall be submitted to SAPPRFT. According to informal phone inquiries with NCAC, to complete the relevant NCAC game license agreement registration, the foreign game developer needs to have obtained a copyright registration in the foreign game developer's home jurisdiction or a registration of the game with NCAC. In the context of using a foreign copyright registration to complete the relevant NCAC game license agreement registration, the certificate of such copyright registration will need to be authenticated by a PRC Consulate in the jurisdiction where such foreign copyright is registered.

In comparison to SAPPRFT, MOC does not impose strict copyright registration obligations on game publishers. Instead of having to submit a certificate of copyright registration, a domestic game publisher may submit to MOC a statement regarding such publisher's copyright ownership of such game, and for a foreign game, although MOC also requires the relevant publisher to provide a copy of the game license agreement, registering such game license agreement is not necessary in order to obtain an MOC approval.

When submitting a copyright registration for a game to NCAC, an applicant or the author of the game must submit an online application form through the NCAC website, which includes submission of certain portions of the game's source code (specifically, the first 30 pages and the last 30 pages), a scanned copy of such applicant's business license and an instruction manual for the game. If the applicant is a foreign game developer, the company establishment documents, such as the certificate or articles of incorporation, will need to be authenticated by a PRC Consulate in the foreign game developer's home jurisdiction.<sup>69</sup> Game copyright registration is supposed to be processed by NCAC within 30 business days of submission.

As mentioned above, copyright registration is prima facie evidence of copyright ownership. According to informal discussion with various industry participants, both MOC and SAPPRFT use copyright registration to determine whether an online game is domestic or foreign. If the online game's copyright is registered under the name of a domestic company,

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<sup>67</sup> See Article 2 of the Copyright Law of the People's Republic of China (中华人民共和国著作权法), issued by National People's Congress Standing Committee (全国人大代表大会常务委员会) on June 7, 1990, and amended on February 26, 2010.

<sup>68</sup> SAPPRFT actually offers an alternative solution, which is to provide full source code of that game together with the evidence proving that the author of such game is a PRC citizen or a PRC domestic company. In practice, it is very rare that a publisher would be comfortable with submitting a game's source code to SAPPRFT, which makes obtaining the copyright registration the only practical solution.

<sup>69</sup> See "[Navigating the Regulatory Landscape in China's US\\$25 Billion Gaming Market](#)", posted at gamasutra.com on February 17, 2017.

MOC and SAPPRFT will treat it as domestic online game, and domestic game approval procedures will apply. If the online game’s copyright is registered under the name of a foreign company, MOC and SAPPRFT will treat it as a foreign online game, and foreign game approval procedures will apply.

In practice, many PRC domestic publishers suggest that foreign game developers should allow them to register game copyrights in China in the name of the domestic publishers in order to cause the game to be classified as a domestic game, and thus subject to the simpler approval process for domestic games. There is some risk, however, that the domestic publisher might be unwilling to later transfer the copyright registration to the foreign developer, which could result in some confusion as to who the actual owner of the game copyright is. As a result, we generally suggest that foreign game developers register the copyright to their games in their own name, even if this will result in a slower game approval process with MOC, and in some instances with SAPPRFT as well.

## 5.5 Game Approval Compliance Scorecard

Over the past seven years, we have conducted a compliance survey with respect to various aspects of China’s digital game regulations, including the game approval requirement.<sup>70</sup> Our compliance checks help to show which regulations are being followed and which regulations are being ignored. Given the more varied nature of China’s legal system relative to the legal systems of developed Western democracies, this information can be very informative when assessing compliance risk. The results of our latest compliance checks are summarized in the compliance scorecard set forth in Annex VI (the “Compliance Scorecard”).

Our Compliance Scorecard indicates that most PC online games are in compliance with the MOC game approval and registration requirements. In each of 2012, 2015 and 2017, the compliance rates were above eighty percent (80%). In addition, mobile game compliance rates have increased each time we conducted this survey. This trend was particularly strong during the past three years when the mobile game compliance rate increased from 22% in 2014 to 86% in 2017. Details of the MOC game approval and registration compliance rates are set forth in the table below.

MOC Game Approval and Registration Compliance Rate

	June 2010	October 2012	April 2014	March 2017
PC Online Game	42%	82%	86%	84%
Mobile Game	N/A	7.5%	22%	86%

Compliance rates for both PC online games and mobile games with respect to the SAPPRFT game approval requirement also increased each time we conducted this survey. PC

<sup>70</sup> There were some minor methodology differences among our compliance checks in 2010, 2012, 2014 and 2017, though we do not believe that these differences had a material effect on the compliance rate data for MOC game approvals and registration. The compliance checks we conducted in 2010 were based on all games listed on the front page of each game operator’s website, while the compliance checks we conducted in 2012 and 2014 were based on the first ten games in the applicable category listed on the front page of each game operator’s website. The compliance check we conducted in 2017 were based on the top 50 PC online games and top 50 mobile games listed on 17173.com, a well-known game information website in China. In addition, due to the material expansion of the mobile game market between 2010 and 2012, we started to check mobile games as an independent category beginning with our 2012 compliance survey.

online game compliance rates increased from 31% in 2010 to 76% in 2017, and mobile game compliance rates increased from 0% in 2012 to 72% in 2017. The large compliance rate increase, especially for mobile games, is most likely attributable to SAPPRFT’s recent decision to more strictly enforce mobile game approvals, including the publishing of a clear requirement that all mobile games must be approved by SAPPRFT before they can be published in a mobile app store. Details of the SAPPRFT game approval compliance rates are set forth in the table below.

SAPPRFT Game Approval Compliance Rate

	June 2010	October 2012	April 2014	March 2017
PC Online Game	31%	38%	54%	76%
Mobile Game	N/A	0%	8%	72%

Compliance rates with respect to the SAPPRFT game approval rules has consistently been lower than compliance rates with respect to the MOC game approval rules, which may reflect the different treatment for domestic games by SAPPRFT and MOC. As noted above, SAPPRFT requires all domestic games, as well as foreign games, to be approved prior to publication, while MOC only requires domestic games to register within 30 days after becoming available online.

## 6. GAME OPERATION AND PUBLICATION LICENSES

As noted in the Section 2.2 (Foreign Ownership Restrictions) above, pursuant to the rules on the books in China, neither foreign companies nor foreign-invested companies are permitted to operate online games, meaning PC online games and mobile games. In order to operate online games in China, the operating company must first obtain the following licenses from various government authorities:

- (1) A value-added telecommunication license, often referred to as an internet content provider or ICP license, issued by MIIT;
- (2) An internet culture operation license, issued by MOC; and
- (3) An online publishing service license, issued by SAPPRFT.

### 6.1 Value-Added Telecommunication License (issued by MIIT)

A company that provides value-added telecommunication services is required to obtain a value-added telecommunications license (增值电信业务经营许可证).<sup>71</sup> Value-added telecommunication services are defined as telecommunications and information services provided through a public network.<sup>72</sup>

<sup>71</sup> See Article 9 of the Telecommunications Regulations of the People’s Republic of China (中华人民共和国电信条例), issued by State Council on September 25, 2000, and amended in February 2016 (the “[Telecommunication Regulations](#)”). The value-added telecommunication license (增值电信业务经营许可证) is often referred to as an “internet content provider license” or an “ICP license”.

<sup>72</sup> See Article 8 of the Telecommunications Regulations.

The catalogue attached to the Telecommunication Regulations, which was updated in 2003 and again in 2015, includes a list of descriptions of value-added telecommunication services and specifies that an “information service” is categorized as a value-added telecommunication service. In the 2003 update to the catalogue, providing game services is categorized as an “information service.”<sup>73</sup> In the 2015 update to the catalogue, although providing game services is no longer specifically categorized as an “information service,” “information service” is defined very broadly to cover almost every conceivable service that can be provided through a website and the internet.<sup>74</sup>

In addition, information services can be subdivided into “information services on a commercial basis” and “information services on a non-commercial basis.” If an internet content provider provides information services through a website on a commercial basis, then such internet content provider should obtain a value-added telecommunication license or ICP license.<sup>75</sup> If an internet content provider provides information services through a website on a non-commercial basis, however, such internet content provider need only register its website with MIIT.<sup>76</sup> In practice, it may be difficult to determine whether a given information service is “commercial” or “non-commercial,” and the standards applied in making such determination often vary among regions.

According to our informal phone inquiries with MIIT’s local office in Beijing (“MIIT Beijing”), MIIT Beijing takes the position that selling products on a company’s website, regardless of whether such products are those of the company or those of a third party, will not in and of itself be deemed “commercial”. If such website incorporates other fee-charging mechanisms, such as charging a monthly fee from its registered members, however, then it will be deemed “commercial”. Displaying third party’s advertisements on the company’s website will also be deemed “commercial”.

MIIT’s local office in Zhejiang (“MIIT Zhejiang”), however, has a different approach. According to our informal phone inquiries with MIIT Zhejiang staff, MIIT Zhejiang takes the position that selling a company’s products on its own website will be deemed an alternative channel of promotion, and therefore not “commercial”. Selling a third party’s products, displaying third party advertisements or posting hyperlinks to third party sites in exchange for fees, however, are viewed as “commercial”. MIIT Zhejiang also takes the position that charging a fee over the internet, regardless of whether it is through a website or via a mobile application, is “commercial”.

The prevailing view with respect to the digital game industry is that operating an online game, regardless of whether it is a PC online game or a mobile game, is an information service offered on a commercial basis, and such online game operator therefore needs to obtain an ICP license. MIIT is responsible for issuing ICP licenses, and these licenses can be obtained at the provincial level offices of MIIT. Such provincial level offices

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<sup>73</sup> Section B2, Subsection 4 of the catalogue issued by MIIT on February 21, 2003.

<sup>74</sup> Section B25 of the catalog issued by MIIT on December 28, 2015.

<sup>75</sup> See Article 7 of the Administrative Measures on Internet Information Services (互联网信息服务管理办法), issued by State Council on September 25, 2000.

<sup>76</sup> See Article 8 of the Administrative Measures on Internet Information Services.

are supposed to make their decisions regarding issuances of ICP licenses within 60 days of their receipt of applications.<sup>77</sup>

Foreign investment in China's telecommunication industry, and consequently the ability of a foreign-invested company to obtain an ICP license, is restricted. Although there are some limited exceptions for businesses established inside the Shanghai pilot free trade zone, to obtain an ICP license, foreign investment in the telecommunication industry must generally take the form of an equity joint venture with the foreign ownership interest not exceeding 50%.<sup>78</sup> However, there is no such ownership restriction for a foreign-invested company to obtain its website registration with MIIT.

## **6.2 Internet Culture Operation License (issued by MOC)**

A commercial operator of internet cultural products in China must obtain an internet culture operation license from MOC.<sup>79</sup> Pursuant to the Interim Provisions on the Administration of Internet Culture issued by MOC on May 10, 2003, online games, including both PC online games and mobile games, are internet cultural products.<sup>80</sup> Consequently, an operator of an online game must first obtain an internet culture operation license to legally operate such online game in China.

An application for an internet culture operation license should be filed with the relevant provincial level office of MOC, and such provincial level office is technically required to make a decision with respect to an application within 20 days from the date of receipt of such application.<sup>81</sup> Once issued, an internet culture operation license shall remain valid for three years before a renewed application must be filed.<sup>82</sup> In addition, holders of an internet culture operation license are required to post the relevant license information on their websites.<sup>83</sup>

Consistent with the prohibition on foreign investment in any company engaged in internet culture activities in China, MOC does not accept applications for internet culture operation licenses from foreign companies or foreign-invested companies.<sup>84</sup> As a result, pursuant to MOC's rules on the books, foreign companies, including foreign-invested companies established in China, are prohibited from directly operating online games, including both PC online games and mobile games, in China.

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<sup>77</sup> See Article 7 of the Administrative Measures on Internet Information Services.

<sup>78</sup> See Article 2 and Article 6 of the Provisions on the Administration of Foreign-Invested Telecommunication Enterprises (外商投资电信企业管理规定), which was issued by the State Council in January 2001 and amended in September 2008. See also Article V Section 7 of the Catalogue of Restricted Foreign Investment Industries, in the Foreign Investment Catalogue. See also the Decisions of the MIIT on Further Opening of Value-Added Telecommunications Service in (Shanghai) Pilot Free Trade Zone.

<sup>79</sup> See Article 6 of the Interim Provisions on the Administration of Internet Culture.

<sup>80</sup> See Article 2 of the Interim Provisions on the Administration of Internet Culture.

<sup>81</sup> See Article 7 of the Interim Provisions on the Administration of Online Games.

<sup>82</sup> See Article 7 of the Interim Provisions on the Administration of Online Games.

<sup>83</sup> See Article 8 of the Interim Provisions on the Administration of Online Games.

<sup>84</sup> See Article 4 of Several Opinions regarding the absorbing the Foreign Investment in Culture Regions (关于文化领域引进外资的若干意见), issued by MOC on July 6, 2005.

### 6.3 Online Publishing Service License (issued by SAPPRFT)

Internet information service providers that make digital works, including but not limited to books, newspapers, audio visual products and games, publicly available on the internet, and in doing so exhibit publishing characteristics, such as editing, production and processing, must obtain an online publishing service license from SAPPRFT.<sup>85</sup>

An application for an online publishing service license should be filed with the relevant provincial level office of SAPPRFT, which will conduct an initial review of the application and then submit it to the main office of SAPPRFT in Beijing. SAPPRFT is technically required to make a decision with respect to an application for an online publishing service license within 60 days after receiving such application.<sup>86</sup>

Consistent with the prohibition on foreign investment in any company engaged in online publishing, SAPPRFT does not accept applications for an online publishing service license from foreign-invested companies, which effectively prohibits foreign companies from operating online games in China.<sup>87</sup> During our informal interviews with SAPPRFT staff, SAPPRFT indicated that it was very unlikely to permit foreign companies to operate online games in China, pointing out that such a change would require a significant policy shift on a government-wide basis because the publishing industry has traditionally been regarded by the Chinese government as very sensitive considering the publishing industry's role as a distributor of ideas. Nonetheless, as discussed in more details below, in practice SAPPRFT does not currently prohibit foreign companies from operating mobile games in China if the mobile games are published through China's Apple App Store.

The requirements a company must meet in order to obtain an online publishing service license are very strict. For example, an applicant must have eight (8) or more specialists that are professionally accredited by SAPPRFT in connection with publishing and editing.<sup>88</sup> Because the requirements are so strict, only a few domestic game operators and traditional state-owned publishing houses are qualified to obtain the online publishing service license. Moreover, the party requesting approval from SAPPRFT in connection with an online game must hold an online publishing service license, which forces domestic game operators that do not have such license to cooperate with a stated-owned publishing house that does have the license in connection with game approvals.

Our compliance checks for leading game operators, as summarized in the Compliance Scorecard set forth in [Annex VI](#), indicate that almost all of the leading domestic game operators have obtained each of the necessary operating licenses.

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<sup>85</sup> See Article 2 and Article 7 of the Administrative Provisions on Online Publishing Service (网络出版服务管理规定), issued by SAPPRFT and MIIT on February 4, 2016.

<sup>86</sup> See Article 11 of the Administrative Provisions on Online Publishing Service.

<sup>87</sup> See Article 4 of Several Opinions regarding the absorbing of Foreign Investment in Culture Regions, and Article 10 of Administrative Provisions on Online Publishing Service.

<sup>88</sup> See Article 8 and Article 9 of Administrative Provisions on Online Publishing Service.

## 6.4 Mobile App Stores and the Game Operation Licenses

According to both the text of the game license rules and our informal inquiries with game regulators at MOC and SAPPRFT, the license requirements described in the sections above also apply to the mobile app stores that distribute the mobile games and other mobile applications. In other words, to operate a mobile app store in China, an operator shall obtain all of the required licenses, including a value-added telecommunication license, an internet culture operation license and an online publishing service license.

According to CAC officials, approximately four million mobile apps are currently available for download through various app stores in China.<sup>89</sup> These numbers reflect the fact that mobile apps are becoming a dominant way to deliver internet information services. As described in greater detail in Section 3 (Overview of China's Game Market) above, in contrast to the United States, where the Google Play Store and Apple App Store dominate mobile app distribution, China's app store market is very fragmented and the number of mobile app stores continues to grow. As a result, China's various regulators, including CAC, increasingly recognize the importance of supervising the mobile app industry in order to implement their policy objectives with respect to this growing market segment.

In June 2016, CAC released the Regulations for the Administration of Mobile Apps Information Service (移动互联网应用程序信息服务管理规定), which sets forth the requirements for mobile app stores to register with the applicable provincial level offices of CAC. Six months later in January 2017, CAC issued the Notice for Registration Management of Online App Stores (关于开展互联网应用商店备案工作的通知) (the "App Store Regulations"), which requires such provincial offices of CAC to start the registration work in connection with mobile app stores, and following the release of the App Store Regulations, the provincial offices of CAC provided detailed information regarding the mobile app store registration procedures and filing requirements. It is worth noting that to complete a mobile app store registration with CAC, neither an internet culture operation license issued by MOC nor an online publishing service license issued by SAPPRFT are required.

In addition, CAC requires mobile app stores to establish management systems to monitor and detect whether app providers publish any illegal information.<sup>90</sup> By placing responsibility for the content of mobile apps upon the mobile app stores that distribute such apps, CAC is supervising the mobile apps indirectly through CAC's authority over the distribution channels. Some basic background regarding China's leading mobile app stores is set forth in Annex III-B (Mobile App Store Pages).

Pursuant to our compliance checks of leading mobile app stores, including China's Apple App Store, there is an 84.6% compliance rate with the value-added communication license requirement, a 77.1% compliance rate with the internet culture operation license requirement and only a 23.1% compliance rate with the online publishing service license requirement. Such data is summarized in the Compliance Scorecard set forth in Annex VI. As indicated in the Compliance Scorecard, we found no evidence that suggests that Apple has obtained the required licenses to operate its app store in China, which is consistent with our

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<sup>89</sup> See Officers of CAC Answering Journalist Questions about the Mobile App Regulations at [Xinhua Net](#).

<sup>90</sup> See Article 8 of Regulations for the Administration of Mobile Apps Information Service (移动互联网应用程序信息服务管理规定) issued by CAC on June 28, 2016.

expectation since Apple is a foreign company and is therefore technically prohibited from obtaining such licenses.

Unlike Google Inc. (“Google”), whose Google Play Store has not been permitted to operate in China, Apple has been permitted to operate its China Apple App Store without obtaining any relevant operation licenses. Apple, unlike Google, appears to have a good relationship with various PRC government authorities, including MIIT. During Apple CEO Tim Cook’s recent eighth visit to China, for example, Miao Wei (苗圩), the Minister of MIIT, publicly provided high praise for Apple’s business in China.<sup>91</sup> Moreover, Apple also appears to be making great efforts to comply with China’s censorship regime, which presumably pleases other PRC authorities, such as MOC and SAPPRFT. For example, in 2012, the PRC government began blocking the New York Times’ website after the New York Times published a series of articles regarding the wealth amassed by the family of Wen Jiabao, who was China’s prime minister at the time. Four years later in December 2016, Apple complied with a request of the PRC authorities to remove both the English-language and Chinese-language versions of the New York Times app from the China Apple App Store.<sup>92</sup> In addition, Apple’s iPhone has a material user base in China, consisting of approximately 13% of all mobile phones in the country.<sup>93</sup> Since the iPhone app ecosystem is a “closed system”, which means that only applications downloaded through Apple App Store can be used on the iPhone, prohibiting Apple from operating its China Apple App Store would risk upsetting the many iPhone users in China.

Given Apple’s seemingly good relationship with the relevant PRC government authorities, the company’s cooperation with China Telecom, China Mobile and China Unicom, the three leading mobile phone service providers in China, and the large number of iPhone users in China, some type of special arrangement for Apple to openly operate its China Apple App Store is likely to continue.

It is also worth noting that Valve’s Steam, a PC game publishing platform, is also available in China. We suspect that Valve, the operator of Steam, has not obtained the required operating licenses since Valve is a foreign company and is therefore prohibited from obtaining such licenses. Although Steam was relatively unknown in China until Dota 2 was released in the second half of 2013, there are now more than 10 million users of Steam in China, making China the second largest Steam region in the world.<sup>94</sup> Steam does not seem to currently be in compliance with China’s censorship regime, as games like Grand Theft Auto V are available for download through the platform in China even though that game has not completed the relevant game approvals and is in fact banned in China. Consequently, it is likely only a matter of time before Steam will be forced to comply with China’s censorship regime or risk being shut down and blocked in China. Now that Tencent has launched a Steam competitor with the WeGame, the end of Steam’s business in China may be near.

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<sup>91</sup> See “Miao Wei Meets Tim Cook, the CEO of Apple” (苗圩回见美国苹果公司首席执行官蒂姆库克) (Chinese), posted at MIIT website on May 19, 2016.

<sup>92</sup> See “[Apple Pulls New York Times App from China Store](#)”, posted at wsj.com on January 4, 2017.

<sup>93</sup> See “[KANTAR: ANDROID MARKET SHARE RISES IN URBAN CHINA](#)”, POSTED AT MARKETWIRED.COM ON APRIL 13, 2017.

<sup>94</sup> See “[Steam Powers on in China to Provide Standalone Games \(and Dota 2\) for a Price](#)”, posted at gamasutra.com on November 13, 2016.

## 6.5 Self-Publishing Mobile Games in China

As mentioned in Section 2.2 (Foreign Ownership Restrictions) above, PRC rules do not permit foreign companies or foreign-invested companies to directly publish or operate online games in China. For PC online games, the requirement that game operators obtain the various operating licenses is well understood and our compliance checks in 2014 and 2017 indicate that almost all of the leading domestic game operators have obtained each of the necessary operating licenses. For mobile games, however, our impression of current practice as well as our informal inquiries with regulators indicate that, currently, it seems unnecessary for a company to obtain any of the required operating licenses in order to operate a mobile game, even though the relevant license requirements do not on their face make a distinction between operating PC online games and operating mobile games.

As discussed in Section 5.2 (SAPPRFT Game Approval Process) above, SAPPRFT now requires mobile app stores in China to verify that the relevant SAPPRFT application and censorship approval process has been completed with respect to each mobile game published through such mobile app stores. Since a game developer can only apply for this game approval if it holds an online publishing service license, and foreign game companies are not allowed to hold such license, there is nonetheless a substantial barrier to self-publishing mobile games in China by foreign and even smaller domestic game companies.

To enforce the SAPPRFT game approval verification requirements, China's mobile app stores, including the China Apple App Store, do not permit developers to publish mobile games in their app stores until such developers supply to such mobile app stores SAPPRFT publication numbers for the mobile games, which evidence having obtained the relevant SAPPRFT approval for such games. Nonetheless, as mentioned in Section 6.4 (Mobile App Store and Game Operation License) above, as of the time of publishing of this memo, submitting the SAPPRFT publication number is not a necessary step for a foreign game developer to be able to publish a mobile game on the China Apple App Store. Foreign companies are not, however, currently able to self-publish mobile games on the various Android app stores in China. When registering for a developer account with an Android app store in China, a developer is generally required to submit a copy of its PRC business license, and based on our informal inquiries with various Android app stores, none of the Android app stores we contacted are willing to allow a foreign company to register as a developer. As a result, it seems that foreign mobile game developers are only able to self-publish in China through the China Apple App Store.

Based on our conversations with various foreign game developers and industry participants, most believe that Apple will eventually require compliance with the SAPPRFT censorship approval with respect to all foreign mobile games, thereby closing what seems like the last remaining opportunity to self-publishing foreign mobile games in China. We have, however, spoken with various agents that assist domestic game developers that do not hold the relevant operating licenses in obtaining SAPPRFT game approvals, and at least some of such agents appear willing to also work with foreign game developers to obtain SAPPRFT game approvals. Even if Apple fully enforces the SAPPRFT game approval requirements, therefore, a foreign mobile game company might still be able to self-publish and operate its mobile games in China through the China Apple App Store with the help of such agents.

While some agents are willing to help obtain SAPPRFT game approvals for foreign game companies, some of those same agents appear less willing to help foreign game

companies obtain MOC game approvals, which foreign game developers are also prohibited from applying for directly. Unlike SAPPRFT, MOC has a history of performing random content compliance reviews for various mobile games available on the market. For example, in September 2016, MOC punished 36 internet culture service providers, including Beijing Changyou Shidai Digital Technology Limited (北京畅游时代技术有限公司) and Shanghai Youzu Information Technology Limited (上海游族信息技术有限公司), two of the leading online game operators in China, for operating online games that contained gambling or pornographic content.<sup>95</sup> Agents we spoke with indicated that MOC's random checks focus on games that, in the domestic game context have completed the MOC game registration, and in the foreign game context have completed MOC game approval. Because the agents would ultimately be held responsible by MOC if the games they helped usher through the MOC censorship process later incorporate content that is not permitted in China, whether an agent is willing to assist with a MOC game approval often depends on the type of game and the nature of its content.

## 7. OPERATION REGULATIONS

In addition to the operation license requirements mentioned above, there are a number of regulations affecting the actual operations of online games in China, the most important of which are summarized below.

### 7.1 Anti-Fatigue System and Real-Name Registration

In April 2007, SAPPRFT and several other government offices jointly issued a notice requiring PC online game operators to implement an anti-fatigue compliance system and real-name registration system in order to curb addictive PC online game playing by minors.<sup>96</sup> In May 2016, SAPPRFT extended the anti-fatigue system requirement to all mobile games other than the newly created category of simple domestic mobile games.<sup>97</sup> Incorporation of an anti-fatigue system into an online game is a condition of SAPPRFT's approval for the game.<sup>98</sup>

Under the anti-fatigue system, three hours or less of continuous play by minors is considered to be healthy, three to five hours to be fatiguing, and five hours or more to be unhealthy.<sup>99</sup> Online game operators are required to reduce the value of in-game benefits such as experience points to a minor game player by half if the game player has reached the fatiguing stage of play, and to zero during the unhealthy stage of play.<sup>100</sup>

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<sup>95</sup> See "[MOC Arranged Random Check on Online Game Market, 200 Entities will be Checked](#)" (文化部部署网络游戏市场随机抽查 200 家单位将接受检查) (Chinese), posted at Xinhua Net on September 28, 2016.

<sup>96</sup> See the Notice on Protecting the Health of Minors by Adopting an Anti-fatigue System in Online Games (关于保护未成年人身心健康实施网络游戏防沉迷系统的通知), issued by SAPPRFT, the Ministry of Information Industry and six other government offices on April 15, 2007 (the "[Anti-Fatigue Notice](#)"), and Article 1 of the Notice Regarding China Initiates Work for the Online Game Real-Name System.

<sup>97</sup> See Article 3, Article 4 and Article 5 of the Mobile Game Approval Notice, and the term "simple domestic mobile games" is defined under Section 5.2 (SAPPRFT Game Approval Process).

<sup>98</sup> See Article 3 of the Anti-Fatigue Notice, and see Article 4 and Article 5 of the Notice Regarding the Administration of Mobile Game Publication Services.

<sup>99</sup> See Annex 1, Section 2.1 of the Anti-Fatigue Notice.

<sup>100</sup> See Annex 1, Section 2.2 of the Anti-Fatigue Notice.

To identify whether a game player is a minor and thus subject to the anti-fatigue system rules, online game operators are obligated to implement a real-name registration system, which requires online game players to register with their real identity information.<sup>101</sup> In addition, online game operators must submit the game player identity information to the public security bureau for verification. Game players who do not register with their real identity information are assumed to be minors.

The effective implementation of the anti-fatigue system has been constrained by challenges associated with verification of real-name registration information provided by users. The Ministry of Public Security has outsourced real-name verification services to a state-owned enterprise under its control — the National Citizen Identity Information Center (全国公民身份证号码查询服务中心) (“NCIIC”). During our informal inquiries with SAPPRFT staff, we learned that to fully implement the real-name verification system, NCIIC must upgrade its server capacity so that it can process identity verifications in real-time. Given the immense computing power required to provide such services with respect to the entire population of China, such goal is difficult for NCIIC to achieve. Without full implementation of the real-name registration, a sophisticated minor can generally evade the anti-fatigue system constraints by registering with either the real identification number of an adult together with a random name, or with a fake identification number that conforms to the 18 digit form of a real personal identification numbers. Conforming fake identification numbers can be generated by a user that understands the form, or by accessing one of the many free websites that provide such fake identification numbers.

Recently, however, authorities in China have taken a new approach to real-name verification, attempting to leverage identity verification work already largely in place with respect to mobile phones. In June 2016, CAC required the copyright owner or operator of each mobile app to authenticate the real identities of their users through such users’ mobile phone numbers.<sup>102</sup> Over the past decade, China’s regulatory authorities made various attempts to implement and enforce a mobile phone real-name registration system. This system called for all mobile phone users to provide their real name and national identification number when registering a new subscriber identity module (“SIM”) card. In May 2016, MIIT issued a notice indicating that it would strictly enforce these requirements, with the goal of full implementation of real-name registration for all SIM cards in China by June 30, 2017. In May 2016, Xinhua, China’s state owned news agency, reported that approximately 92% of mobile phone users in China had already registered their SIM cards with real identity information.<sup>103</sup>

Authenticating a user’s real identity through his or her mobile phone number might achieve the goal of real-name verification for online games, including both PC online games and mobile games. This approach is also being taken to verify real identities with respect to other internet services, including not only those normally accessed through a mobile phone but also those that are often or sometimes accessed through a PC, such as China’s popular messaging and microblog services. For example, to complete the registration process for a QQ account, which can be used to access all online games operated by Tencent as well as

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<sup>101</sup> See Annex 2 of the Anti-Fatigue Notice.

<sup>102</sup> See Article 7, Section 1 of the Regulations for the Administration of Mobile Apps Information Service.

<sup>103</sup> See “[The Strictest Mobile Real-Name Registration Rule is Coming! Cease Service if Fails to Comply](#)” (最严手机实名制来了！不实名将停止服务) (Chinese), posted at Xinhuanet.com on May 25, 2016.

other Tencent services, each user must provide his or her mobile phone number and then authenticate such mobile phone number by typing in an access code that is sent to the phone by text message. A similar mobile phone real-name registration process is used to establish an account with Sina Weibo – China’s Twitter style microblog service.

Although a sophisticated minor may also be able to evade the anti-fatigue system by using his or her parent’s mobile phone numbers to register the account, the successful implementation of a real-name registration process is still arguably a positive development with respect to achieving the goals of the anti-fatigue rules. This development, however, is also likely to have important implications for online censorship under China’s strict government rules.

Our latest compliance check with respect to real-name registration in March 2017 indicates that many online games currently require their players to provide their mobile phone numbers and to authenticate such mobile phone numbers by text message in order to complete the registration process. Although real-name registration compliance rates are still relative low, by gradually implementing the new real-name registration process required by CAC, we anticipate that these compliance rates will increase sharply in the coming years. PC online games have a real-name registration rule compliance rate of forty percent (40%). Real-name registration rule compliance rates for mobile games is lower, with Android games having a compliance rate of twenty-eight percent (28%), and iOS games having a compliance rate at or near zero.

For more details regarding the results of our real-name registration compliance checks, please see the Compliance Scorecard set forth in [Annex VI](#).

## **7.2 Virtual Currency Rules**

In February 2007, the People’s Bank of China, which is China’s central bank responsible for both monetary policy and bank regulation, was issued a directive to strengthen the administration of online game virtual currency to avoid any adverse impact on the real economy.<sup>104</sup> In order to implement this policy goal, the following specific instructions were also included in the directive:

- (1) strictly limit the amount of online game virtual currency that an online game operator may issue;
- (2) strictly separate virtual transactions from e-commerce purchases of real goods, including by ensuring that online game virtual currency issued by a game operator can only be used to purchase online game virtual items and services provided by that game operator; and
- (3) if users must convert online game virtual currency back into real currency, to limit the amount that may be converted to no more than the original amount purchased.

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<sup>104</sup> See Article I, Section 5 of the Notice on Strengthening the Administration of Internet Café and Online Game (关于进一步加强网吧及网络游戏管理工作的通知), jointly issued by 14 government departments including MOC, the State Administration For Industry and Commerce, the Ministry of Public Security, and the Ministry of Information Industry on February 15, 2007.

In June 2009, MOC and the Ministry of Commerce (商务部) (“MOFCOM”) jointly issued, with the support and approval of the People’s Bank of China, a virtual currency notice that regulates the issuance and trading of online game virtual currency (the “Virtual Currency Notice”).<sup>105</sup> The term “online game virtual currency”, as originally defined in the Virtual Currency Notice, only refers to digital currencies that exist outside the online game,<sup>106</sup> but in December 2016, MOC expanded the scope of virtual currency to also include any game currency inside an online game that can be purchased with legal currency, which is also known as “purchased virtual currency”.<sup>107</sup> It is worth noting that the term “online game virtual currency” does not refer to game currency inside an online game that can be earned by players by playing the game, which is also known as “earned virtual currency”, and therefore the Virtual Currency Notice does not apply to earned virtual currency. In addition, issuance and trading of “virtual items” that can be purchased with legal currency or purchased virtual currency is also subject to China’s online game virtual currency rules.<sup>108</sup> China’s online game virtual currency rules attempt to achieve the policy goal of ensuring that online game virtual currency does not have an adverse impact on the real economy by:

- (1) drawing a clear line between online game virtual currency issuing services and online game virtual currency trading services. For example, no company may operate both as a virtual currency issuer and a virtual currency trading platform.<sup>109</sup> In addition, an issuer of online game virtual currency is required to use technical means to prevent the transfer of online game virtual currency between user accounts.<sup>110</sup>
- (2) requiring online game operators that issue online game virtual currency and operators of platforms that facilitate trading of online game virtual currency to each hold internet culture operations licenses issued by MOC and to obtain online game virtual currency approval from MOC.<sup>111</sup>
- (3) limiting online game virtual currency to be purchased only with legal currency and to be used only to pay for virtual items and services provided by the issuer, and not for tangible products or for third party products and services.<sup>112</sup>
- (4) generally prohibiting online game virtual currency and virtual items from being redeemed by players in exchange for legal currency, with the exception that online game operating companies may redeem online game virtual currency in exchange for physical products of relatively low value.<sup>113</sup>

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<sup>105</sup> The Notice on Strengthening Administration of Virtual Currency in Online Games (关于加强网络游戏虚拟货币管理工作通知), jointly issued by MOC and the Ministry of Commerce on June 4, 2009 (the “Virtual Currency Notice”).

<sup>106</sup> See Article 1, Section 1 of the Virtual Currency Notice.

<sup>107</sup> See Article 2, Section 4 of the Notice regarding Regulating Online Game Operation and Strengthening the Monitoring Works (文化部关于规范网络游戏运营加强事中事后监管工作的通知) issued by MOC on December 5, 2016 (the “MOC Online Game Notice”).

<sup>108</sup> See Article 2, Section 4 of the MOC Online Game Notice.

<sup>109</sup> See Article 1, Section 2 of the Virtual Currency Notice.

<sup>110</sup> See Article 2, Section 13 of the Virtual Currency Notice.

<sup>111</sup> See Article 1, Section 2 of the Virtual Currency Notice.

<sup>112</sup> See Article 2, Section 8 of the Virtual Currency Notice.

<sup>113</sup> See Article 2, Section 9 and Section 10 of the MOC Online Game Notice.

- (5) requiring issuers to issue online game virtual currency in an amount appropriate for their operational needs. Online game operators are also required to submit reports to relevant provincial cultural administrative authorities on a quarterly basis, specifying the total amount of online game virtual currency issued.<sup>114</sup>

### **7.3 Parental Control System and Minor Protection**

In February 2010, under the guidance of MOC, six leading online game companies in China, consisting of Changyou.com Limited, Giant Interactive Group Inc., Netease, Inc., Perfect World Co., Ltd., Shanda Games Limited, and Tencent Holdings Limited, voluntarily launched a parental control project. In March 2011, MOC and several other ministries and agencies under the State Council formally adopted this project and participation become mandatory for all online game companies.<sup>115</sup>

The parental control project is intended to provide parents with the means to monitor and control the online game activities of their children. By participating in the project, parents are able to control when and for how long their children are allowed to play online games, and even to completely prohibit their children from playing online games. To initiate the parental controls, a parent must file an application with the relevant game company, providing information regarding the game account or accounts of their child, proof of his or her relationship with his or her child and the restrictive methods that he or she would like to adopt.

Each online game company is required to undertake a number of measures in order to implement the parental control project, including:

- (1) Appointing and training specific personnel to communicate with parents, and tracking each of the parental control applications;
- (2) Establishing a specific telephone number that parents can call with questions, and providing various additional communication channels, such as fax and email, to allow parents to conveniently submit their applications;
- (3) Creating a parental control zone in a prominent location on the game company website, which shall include detailed instructions about how to file an application; and
- (4) Providing quarterly reports to the relevant local office of MOC with respect to the parental control program implementation.<sup>116</sup>

Our 2014 compliance checks indicated a near perfect compliance rate among PC online games with respect to the parental control requirements. Given the very high early

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<sup>114</sup> See Article 2, Section 6 of the Virtual Currency Notice.

<sup>115</sup> See "[China Now Let's Parents Control Kids' Access to Online Games](#)", posted at geek.com on February 2, 2011.

<sup>116</sup> See Article 2 of the Implementation Plan of the Online Game Parental Control Project for Minors ("网络游戏未成年人家长监护工程"实施方案), issued by eight government departments including the Ministry of Public Security and MOC on January 15, 2011.

compliance rates, we did not include parental control requirements in our 2017 compliance checks.

Notwithstanding the very high compliance rate among leading game operators, it is unclear whether or not the system is actually useful to parents. During the one-year testing period for the project, for example, the number of parental applications actually received by participating online game companies was very limited.<sup>117</sup> In addition, the application procedure is burdensome, requiring multiple applications to different companies if a minor plays online games offered by different publishers. The potential for minors to establish game accounts with fake registration information is an additional barrier to the effective implementation of the parental control system.<sup>118</sup>

In addition to the anti-fatigue system and this parental control system, the authorities in China have passed additional measures that are also intended to limit the amount of time that minors spend playing online games. In June 2010, MOC prohibited third party virtual currency transaction platforms from providing any transaction services to minors.<sup>119</sup> This policy decision was primarily aimed at discouraging minors from engaging in “gold farming”, which is facilitated by the secondary market for the buying and selling of in-game virtual currency, in-game virtual items and even whole game accounts, that is created by the virtual currency transaction platforms. A “gold farmer” earns virtual currency in an online game by engaging in repetitive actions designed to maximize their virtual currency income, and then sells that virtual currency for real currency on a virtual currency transaction platform.<sup>120</sup> Although it is easy to understand the potential harmful effect that gold farming might have on minors,<sup>121</sup> as with the various other restrictions directed at minors, the effectiveness of this prohibition is limited by the ability of underage game players to register accounts with fake identification information.<sup>122</sup>

In addition to the rules described above, the State Council is also drafting new regulations focused on protecting minors online. The preliminary draft of the regulation that the State Council published for public comment, generally reaffirms the existing requirements with respect to the real-name registration and anti-fatigue system for online games.<sup>123</sup> The draft regulation also indicates that minors might be prohibited from playing online games between midnight and eight o’clock in the morning each day.<sup>124</sup>

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<sup>117</sup> See “[Online Game Parental Control Project Launched Today, Almost No Game Accounts were Forbidden During the Testing Period](#)” (网游家长监护工程今起实施 试行期间几无封号) (Chinese), posted at sina.com.cn on March 1, 2011.

<sup>118</sup> See “[Online Game Parental Control Project Launched Today, Almost No Game Accounts were Forbidden During the Testing Period](#)” (网游家长监护工程今起实施 试行期间几无封号) (Chinese), posted at sina.com.cn on March 1, 2011.

<sup>119</sup> See Article 2, Section 16 of the Virtual Currency Notice.

<sup>120</sup> See “[Gold Farming: A New Profession Drifting on the Edge of the Law](#)” (网络游戏代练：游走在法律边缘的新职业) (Chinese), posted at Xinhuanet.com.cn on June 30, 2008, and “[RMB 20,000 Monthly Salary: Becoming the Public Enemy of Game Operators](#)” (月入2万网络游戏代练：成游戏运营商公敌) (Chinese), posted at Sina.com.cn on January 17, 2010.

<sup>121</sup> See “[Minors Will Not be Allowed to Conduct Virtual Currency Transactions](#)” (未成年人将被禁交易虚拟货币) (Chinese), posted at Hainan.net on June 23, 2010.

<sup>122</sup> See “[ID Generator: How to Protect the Safety of Information?](#)” (身份证生成器：信息安全如何保障?) (Chinese), posted at enet.com.cn on June 30, 2010.

<sup>123</sup> See Article 22 and Article 23 of the Regulation on Protection of Minors Online (Pre-Approval Draft) (未成年人网络保护条例（送审稿）), issued by State Council on January 6, 2017.

<sup>124</sup> See Article 22 and Article 23 of the Regulation on Protection of Minors Online (Pre-Approval Draft).

## 7.4 Rating System

In 2010, Tuo Zuhai, the vice director general of the Department of Cultural Market Administration of MOC, indicated that MOC would not adopt a rating system for online games in China.<sup>125</sup> During informal inquiries, MOC staff indicated that adopting a rating system for all of China would be difficult due to significant differences in opinion regarding what is appropriate game content among the various regions of the country. MOC staff indicated, for example, that people in the coastal regions have a more liberal attitude toward what they regard as pornographic when compared to those in the more conservative internal provinces.

SAPPRFT also indicated that, notwithstanding a great deal of discussion on the issue, China is not likely to implement a rating system for digital games. During informal inquiries, SAPPRFT staff explained that the current standard for publication is based on what can be viewed by children, and thus the standard is very strict. If a rating system is introduced, the implication is a loosening of the standards, which would involve a shift of responsibility from the government to parents with respect to ensuring that children do not view inappropriate content. SAPPRFT staff did not believe that the general population was willing to accept this responsibility and that many people thought that if content should not be viewed by children then the government should not allow that content to be published.

Notwithstanding the resistance to a formal rating system, MOC does require game operators to post warning notices based on game content, game functions and target users.<sup>126</sup> Although MOC has not provided any additional public guidance on the required content of these warning notices, many game operators provide warning notices with an age-based rating that indicates whether such game is or is not suitable for minors to play.

In addition, local governments in Beijing and Shanghai have introduced age-based rating notice requirements for PC online game companies headquartered within such jurisdictions. In January 2010, over 30 PC online game companies in Beijing voluntarily agreed to post on the websites for each of their games an age-based rating notice that indicates whether the game is appropriate for users under 18 or only for users over the age of 18.<sup>127</sup> In July 2010, the Shanghai office of MOC issued a notice requiring all Shanghai-based PC online game companies to display similar age-based rating notices on the websites for each of their games.<sup>128</sup> In addition, the Shanghai office of MOC's notice requires games suitable only for users over the age of 18 to incorporate technology that prevents minors from playing the games.<sup>129</sup>

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<sup>125</sup> See "[Tuo Zuhai of MOC: China Does Not Have the Conditions to Implementing a Rating System](#)" (文化部庹祖海：网游分级制不具备可实施条件) (Chinese), posted at ifeng.com on June 22, 2010.

<sup>126</sup> See Article 16 of the Interim Provisions on the Administration of Online Games.

<sup>127</sup> See "[Beijing will Implement the Age-Based Notices, which is Different from the Rating System for Online Games](#)" (北京推进网游适龄提示 不同于网游分级) (Chinese), posted at ifeng.com on January 28, 2010.

<sup>128</sup> See Article 1 of the Notices Regarding the Implementation of the Interim Provisions on the Administration of Online Games (关于贯彻落实《网络游戏管理暂行办法》有关规定的通知), issued by MOC Shanghai Office on July 27, 2010.

<sup>129</sup> See Article 1 of the Notices Regarding the Implementation of the Interim Provisions on the Administration of Online Games.

In 2012 and 2014, we checked compliance with the rating notice requirements among several leading online game operators in China. The findings suggest that the skepticism of MOC and SAPPRFT toward rating systems is well understood in the market – there was a 42% compliance rate in 2012, which fell to only a 15% compliance rate in 2014. Given the low compliance rates in the past, and the lack of new regulations with respect to a rating system since 2010, we did not check compliance with the rating notice requirement in 2017.

## 7.5 Marketing Restrictions

Pursuant to the Interim Provisions on the Administration of Online Games issued by MOC on June 3, 2010 and effective on August 1, 2010, the promotion and advertisement materials for an online game must not include any materials that violate the general internet content censorship rules.<sup>130</sup> Around the time that these rules were issued, several PRC online game companies hired women who achieved fame through sex scandals or pornographic films as spokespersons to market and promote their online games.<sup>131</sup> In an apparent reaction to this, in July 2010, MOC issued an additional notice that prohibited game companies from using vulgar methods to promote online games.<sup>132</sup> According to the notice, local MOC branch offices should monitor online game marketing and are authorized to punish game companies that violate the vulgar marketing prohibition. These rules indicate that MOC views its regulatory authority as being broader than mere regulation of the content of online games, but also to regulate other aspects of the industry including online game advertising and promotion.<sup>133</sup>

In November 2011, MOC indicated that Xunlei, Sina and 32 other game operators violated content restrictions and used vulgar methods to promote the sale of their online games.<sup>134</sup> Moreover, the rules restricting the promotional methods for online games also apply to mobile app stores. In December 2014, MOC punished 13 mobile app store operators, including Tencent, Baidu and Wan Dou Jia, because certain promotions relating to the sale of mobile games published on their app stores violated internet content restrictions.<sup>135</sup>

## 7.6 Personal Information and Privacy

Although online privacy is not the contentious policy issue in China that it is in the United States or Europe due to, among other factors, the nature of the political system in each

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<sup>130</sup> See Article 12 of Interim Provisions on the Administration of Online Games. Detail discussion of general internet content restriction included in section “General Internet Content Restriction”.

<sup>131</sup> See “[China Targets 'Vulgar' Advertising for Online Games](#)”, posted at BBC News on July 8, 2010.

<sup>132</sup> See the Notice Regarding Prohibiting Game Companies from Using Vulgar Methods to Promote the Sale of Online Games (文化部文化市场司关于加强网络游戏市场推广管理 制止低俗营销行为的函), issued by MOC on July 7, 2010.

<sup>133</sup> See the Notice Regarding the General Office of MOC Punishing the Illegal Internet Culture Events (12th) (文化部办公厅关于查处第十二批违法互联网文化活动的通知), issued by MOC on April 12, 2011. Also see Article 9 of the Interim Provisions on the Administration of Online Games, pursuant to which MOC has the authority to ensure that the online games do not contain any illegal content.

<sup>134</sup> See “[The 14<sup>th</sup> Batch of Illegal Internet Culture Activities Punished by MOC](#)” (文化部查处第十四批违法互联网文化活动的通知) (Chinese), posted at cwan.com on November 24, 2011.

<sup>135</sup> See the Notice Regarding the General Office of MOC Punishing the Illegal Internet Culture Events (22th) (文化部办公厅关于查处第二十二批违法互联网文化活动的通知), issued by MOC in December 2014.

jurisdiction and the different approaches to internet law and policy, China does have several rules that regulate how online game operators manage the personal information of their users.

In July 2010, MOC released rules that require online game operators to incorporate into their user service agreements certain standard clauses, many of which relate to the use and protection of customer personal information.<sup>136</sup> These rules require online game players to provide their real-name personal information to online game operators, which is consistent with prior requirements associated with implementation of the anti-fatigue system for minors.<sup>137</sup> In order to encourage players to provide their real-name registration information, the rules indicate that if a game account is stolen and the account holder did not provide his real-name registration information when establishing the account, then the online game operator is not required to assist the player in recovering the stolen account.<sup>138</sup> These rules also require each online game operator to publish its privacy policy and ensure the safety of users' personal information.<sup>139</sup>

In December 2011 and again in July 2013, MIIT issued rules, which are applicable to all internet information service providers including game operators, relating to the protection of personal information of internet users. These rules, among other things, require user consent prior to the collection of any personally identifiable information or the sharing of such information with third parties.<sup>140</sup> In addition, internet information service providers may only collect the personal information that is necessary to provide their services and shall expressly inform users of the method, content and purpose of the collection and processing of such personal information.<sup>141</sup> Internet information service providers are also required to establish and publish their rules relating to personal information collection or use, to keep any collected information strictly confidential and to take adequate measures to ensure the security of this information.<sup>142</sup>

In June 2016, CAC released rules prohibiting mobile app providers from collecting a customer's location information, accessing a customer's contact list or using a customer's phone camera or voice recording functions, each without the prior consent of the customer.<sup>143</sup>

In November 2016, the Standing Committee of the National People's Congress promulgated the Cyber Security Law. The Cyber Security Law applies to "network operators", a term that is defined in very broadly to include network owners, administrators

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<sup>136</sup> See the Required Standard Clauses for Online Game Service Agreements (网络游戏服务格式化协议必备条款), issued by MOC on July 30, 2010.

<sup>137</sup> See Articles 1.1 and 2.1 of the Required Standard Clauses for Online Game Service Agreements.

<sup>138</sup> See Article 2.4.3 of the Required Standard Clauses for Online Game Service Agreements.

<sup>139</sup> See Article 4.1 of the Required Standard Clauses for Online Game Service Agreements.

<sup>140</sup> See Article 11 of the Several Provisions on Regulating the Market Order of Internet Information Services (规范互联网信息服务市场秩序若干规定), issued by MIIT on December 29, 2011 and Article 9 of the Order for the Protection of Telecommunication and Internet User Personal Information (电信和互联网用户个人信息保护规定), issued by the Ministry of Industry and Information Technology on July 16, 2013.

<sup>141</sup> See Article 11 of the Several Provisions on Regulating the Market Order of Internet Information Services.

<sup>142</sup> See Article 13 of the Order for the Protection of Telecommunication and Internet User Personal Information.

<sup>143</sup> See Article 7, Section 4 of the Regulation for the Administration of Mobile Apps Information Service.

and service providers,<sup>144</sup> and which we believe also includes online game operators. The Cyber Security Law restates the existing rules regarding the protection of user personally identifiable information, including the requirement to expressly inform users of the purpose and scope of the collection of personally identifiable information, and the requirement to obtain user consent for such information collection. In addition, a network operator is not permitted to collect personally identifiable information that is not relevant to the services such network operator is providing.<sup>145</sup>

In December 2016, MOC released rules reaffirming the requirement that online game operators establish security protection mechanisms to prevent any leak, damage or unauthorized access to users' personal information.<sup>146</sup>

In April 2017, CAC released for public comment draft rules that would require companies, organizations and individuals in China to apply for permission, under certain circumstances, to transmit personal information and critical data ("Digital Data") outside of China (the "Draft Overseas Data Transfer Rules"). Similar to the Cyber Security Law, the Draft Overseas Data Transfer Rules apply to "network operators",<sup>147</sup> which we also believe includes online game operators. Pursuant to the Draft Overseas Data Transfer Rules, if personally identifiable information is transferred outside of China, the internet operators transferring such data would be required to clearly explain to users the purpose of collecting such information, the scope of the personally identifiable information collected and the countries or regions where the intended recipients of such information are located.<sup>148</sup> In addition, under the Draft Overseas Data Transfer Rules, a network operator would be prohibited from transferring a user's personally identifiable information outside of China without the prior consent of such user,<sup>149</sup> and such network operator would be required to submit an application to its respective primary industry regulator for a security assessment with respect to a proposed transfer of Digital Data outside of China, if, among other things, (i) such Digital Data includes personally identifiable information of more than 500,000 persons, irrespective of whether this threshold is met with respect to a single transfer or on an aggregate basis by way of multiple transfers; or (ii) the storage size of the Digital Data exceeds 1,000 gigabytes.<sup>150</sup> Although the Draft Overseas Data Transfer Rules have only been published for comment and are therefore not yet effective nor finalized, such Draft Overseas Data Transfer Rules signal the PRC government's intention to tighten regulation on the transfer of digital information.

Compliance with the various personal information and privacy rules requires each online game operator to undertake the following tasks:

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<sup>144</sup> See Article 76(3) of the Cyber Security Law of the People's Republic of China (中华人民共和国网络安全法), issued by the Standing Committee of the National People's Congress on November 6, 2016 (the "Cyber Security Law").

<sup>145</sup> See Article 41 of the Cyber Security Law.

<sup>146</sup> See Article 3, Section 15 of the Notice of Interim and Post-Event Supervision of Regulating Online Game Operation.

<sup>147</sup> See Article 2 of the Measures for Security Assessment of Transferring Personal Information and Critical Data Overseas (Draft for Comments) (个人信息和重要数据出境安全评估办法 (征求意见稿)), issued by CAC on April 11, 2017 (the "Overseas Data Transfer Draft").

<sup>148</sup> See Article 4 of the Overseas Data Transfer Draft.

<sup>149</sup> See Article 11 of the Overseas Data Transfer Draft.

<sup>150</sup> See Article 9 of the Overseas Data Transfer Draft.

- (1) Implement a real-name registration system;
- (2) Prepare and disclose to users such online game operator's privacy policy;
- (3) Obtain user consent before collecting any personal information. In the case of a mobile app store, obtain user consent before collecting a customer's location information, accessing a customer's contact list or using a customer's mobile phone camera or voice recording function;
- (4) Maintain the confidentiality of users' personal information, and obtain user consent before sharing any users personal information with a third party; and
- (5) Not to collect any user personal information that is not relevant to the service being provided by such online game operator.

## **8. MISCELLANEOUS ADDITIONAL REGULATIONS**

### **8.1 Internet Cafés**

Historically, internet cafés have been one of the primary means by which people in China access the internet, including to play online games. Concern over the potential harmful effects of internet café culture on minors and others in China, however, has led to a number of rules and regulations restricting the operations of internet cafés, including a prohibition on allowing minors to enter their premises. MOC, which has traditionally been one of the primary regulators of internet cafés, has adopted a policy of promoting the development of large chains in the hope that bigger businesses will provide facilities that are safer, better managed and more likely to comply with the relevant regulations. Based on information provided during our informal interviews with MOC, we understand that MOC's primary goal is to protect underage internet users who might gain access to internet cafés that are less committed to regulatory compliance.

In 2002, the State Council promulgated rules that prohibit internet cafés from admitting minors, restrict internet café hours to between 8:00 o'clock in the morning and midnight, and ban the operation of internet cafés near schools and in residential areas. In February 2007, and again in March 2012, various central governmental departments issued notices increasing the penalties for internet cafés that admit minors.<sup>151</sup>

In 2007, MOC began restricting the number of internet cafés in operation in order to promote the policy goal of establishing larger chains.<sup>152</sup> The permitted number of internet cafés, as well as the minimum number of personal computers per café, are set at the provincial level based on economic circumstances, population and other relevant local factors.

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<sup>151</sup> See Article 9 and Article 22 of the Regulations on the Administration of Business Sites of Internet Access Services (互联网上网服务营业场所管理条例), issued by the State Council on September 29, 2002, and Article 1 (subsection 1) of the Notices Regarding Further Strengthening the Administration of Internet Cafés and Online Games and the Notice Regarding Increasing the Punishment for Internet Cafés that Admits Minors (文化部关于加大对网吧接纳未成年人违法行为处罚力度的通知), issued by MOC on March 13, 2010.

<sup>152</sup> See Article 2 (subsection 1) of the Notices Regarding Further Strengthening the Administration of Internet Café and Online Games (关于进一步加强网吧及网络游戏管理工作的通知), issued by 14 government departments including MOC, the State Administration For Industry and Commerce, the Ministry of Public Security, and the Ministry of Information Industry on February 15, 2007.

Certain media outlets have noted, however, that strict implementation of these regulations may encourage minors to play online games at “black internet cafés” (黑网吧), which operate without a formal licenses.<sup>153</sup> In addition, in smaller cities and towns where internet cafés are often the primary channel to access the internet, these regulations are not always strictly enforced.<sup>154</sup> Perhaps in an effort to address these concerns, MOC and the Ministry of Finance (财政部) adopted a policy in 2012 to promote the creation of public electronic reading rooms as an alternative to internet cafés, indicating that the central government would fund between 50 to 80% of the costs associated with such rooms, with the exact amount varying among provinces.<sup>155</sup>

The relevance of internet cafés in China has decreased over recent years, however, as the popularity of personal computers and mobile games has increased.<sup>156</sup> Perhaps in an effort to promote the internet café industry, in November 2014, MOC loosened some of the restrictions on the operation of internet cafés, including, among other things, limitations regarding the number of internet cafés and minimum number of computers per internet café,<sup>157</sup> and in certain pilot region, such as Beijing, Shanghai, Changsha and Chengdu, MOC has also loosened limitations regarding hours of operation of internet cafés.<sup>158</sup> Some restrictions, such as a requirement that an internet café be no less than 20 square meters in size and that at least 2 square meters of such space be devoted to each computer in the internet café, continue in effect.<sup>159</sup> Note, however, that lower standards may be applied by MOC at the provincial level. For example, in Shanghai, there is no minimum operation area requirement for internet cafés.<sup>160</sup>

## 8.2 E-sports in China

E-sports has increased in popularity in China in recent years. In 2009, the World Cyber Games, the world’s largest video game tournament, was hosted in Chengdu, a city in western China, bringing over 600 e-sport participants to China with approximately

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<sup>153</sup> See [“Guangzhou Implements the Real-Name Registration in Internet Cafés, Be Vigilant that Minors Will Turn to Black Internet Cafés”](#) (广州实行网吧实名制 警惕未成年人转向黑网吧) (Chinese), posted at ifeng.com on July 8, 2010.

<sup>154</sup> See [“It is Common that Minors in Xiangtan Enter the Internet Cafés During the Summer Holidays”](#) (湘潭未成年人暑假泡网吧现象普遍) (Chinese), posted at zjjzx.cn on July 19, 2010.

<sup>155</sup> See Article 6 (subsection 2) of the Implementation Plan of the Public Electronic Reading Rooms Construction Plan (“公共电子阅览室建设计划”实施方案), issued by MOC and the Ministry of Finance on February 3, 2012.

<sup>156</sup> See [“Internet Café Industry Status and Analysis”](#) (网吧行业现状与分析) (Chinese), posted at mp.weixin.qq.com on September 20, 2016.

<sup>157</sup> See Article 2, Section 1 of the Notice on Strengthening of Law Enforcement and Supervision, Perfect Management Policies and Promoting the Healthy and Orderly Development of The Internet Service Industry (关于加强执法监督 完善管理政策 促进互联网上网服务行业健康有序发展的通知), issue by MOC on November 24, 2014.

<sup>158</sup> See Article 2, Section 4 of the Notice on Strengthening of Law Enforcement and Supervision, Perfect Management Policies and Promoting the Healthy and Orderly Development of The Internet Service Industry.

<sup>159</sup> See Article 2, Section 1 of the Notice on Strengthening of Law Enforcement and Supervision, Perfect Management Policies and Promoting the Healthy and Orderly Development of The Internet Service Industry.

<sup>160</sup> See [“Shanghai Published Internet Service Business Area Industry Standard”](#) (上海互联网上网服务营业场所行业标准发布) (Chinese), posted at MOC website on October 14, 2016.

US\$500,000 in prize money at stake.<sup>161</sup> In 2012 and 2013, the World Cyber Games was hosted in Kunshan, a city in eastern China, bringing in approximately 110,000 and 155,000 live spectators, respectively.<sup>162</sup>

Internet companies contribute to the booming e-sports market in China. In 2015, Perfect World cooperated with a Chinese culture company to broadcast e-sports programs on twenty (20) provincial level television stations.<sup>163</sup> In 2016, Alibaba Group launched Ali Sports World Electronic Sports Games, which included a total of US\$5.5 million in prize money.<sup>164</sup> According to a 2016 China Gaming Industry Report (中国游戏产业报告), revenue of approximately RMB50.4 billion were generated in 2016 in connection with e-sports in China. This rapid growth of e-sport has not gone unnoticed by the PRC government, who has instituted various measures to supervise the industry.

The first wave of China e-sports emerged in 1998 with the widespread popularity of StarCraft.<sup>165</sup> Five years later in 2003, the PRC government recognized e-sports as an official sports program to be supervised by the General Administration of Sport of China (国家体育总局) (“GASC”).<sup>166</sup> Only one year later in 2004, SAPPRFT issued a notice prohibiting all radio and television stations in China from broadcasting e-sport programs.<sup>167</sup>

In 2007, however, the PRC government changed its attitude towards e-sports from one of prohibition to one of support. That year, GASC formed a team to participate in the competition programs of the Asia Indoor and Martial Arts Games. In 2009, GASC established an office to manage e-sports, and has since hosted some e-sports competitions, including competitions in connection with the games DOTA, StarCraft, League of Legends and Hearthstone.<sup>168</sup> On July 24, 2015, GASC released the Interim Provisions of E-Sports Competition Management (电子竞技赛事管理暂行规定), which are applicable to competitions hosted or co-hosted by GASC. Furthermore, in September 2016, MOC issued the Opinion of Promoting Culture and Entertainment Industry Transformation and Upgrading (文化部关于推动文化娱乐行业转型升级的意见), which encourages game industry associations and online game companies to work together to host e-sports competitions and tournament series.<sup>169</sup>

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<sup>161</sup> See “[Chengdu holds 2009 World Cyber Games](#)” (2009 世界电子竞技大赛总决赛落户成都) (Chinese), posted at Xinhua Net on April 23, 2008.

<sup>162</sup> See Marcella Szablewicz, “[China’s E-Sports Paradox](#)” (English), posted at Slate.com on March 29, 2016.

<sup>163</sup> See “[Perfect World and Hua Yi Created E-Sport Programs in Twenty \(20\) Province](#)” (完美联手华懿与 20 家电视台推出电竞节目) (Chinese), posted at Hexun.com on February 13, 2015.

<sup>164</sup> See Callum Leslie, “[Chinese Ecommerce Giant Alibaba Launching US\\$5.5 Million Esports Tournament Series](#)”, posted at Dot Esports on March 31, 2016.

<sup>165</sup> See “[The Eight Steps of Chinese E-Sports Development](#)” (中国电子竞技发展至今的八块基石) (Chinese), posted at NetEase News website on May 20, 2016.

<sup>166</sup> See “[E-Sports has been Recognized as the 99<sup>th</sup> Official Program](#)” (电子竞技被体育总局列为第 99 个正式体育项目) (Chinese), posted at Tencent News website on November 21, 2011.

<sup>167</sup> See “[Notice to Ban the Broadcasting of Video Games Programs](#)” (禁止播出电脑网络游戏类节目通知) (Chinese), posted at Xinhua Net on April 12, 2004.

<sup>168</sup> See “[E-Sports Information Update](#)” (电子竞技信息发布) (Chinese), posted at GASC website.

<sup>169</sup> See Article 5 of the Opinion of Promoting Culture and Entertainment Industry Transformation and Upgrading (文化部关于推动文化娱乐行业转型升级的意见), issued by MOC on September 21, 2016.

Mobile e-sports is also growing rapidly in China. According to a February 2016 Newzoo Report, twenty-four (24) of the top one hundred (100) mobile games across all Android stores in China, and nineteen (19) of the top one (100) mobile games on the iOS platform, are considered e-sports titles with organized tournaments. China is by far the largest market in the world for e-sports by audience, with approximately 82 million people having watched e-sports through various live streaming platforms in 2015.<sup>170</sup> In contrast to the United States, where Twitch Interactive, Inc.’s Twitch platform dominates e-sport online broadcasting, China’s live streaming market is very fragmented and the number of live streaming platform that broadcasting e-sports continues to grow.

### 8.3 Live Online Streaming Rules

With the widespread development of live online streaming, the PRC authorities have recognized that supervision and management of the online live streaming industry, which includes publishing real-time or recorded videos of online game play, is essential.

On November 4, 2016, CAC released the Administrative Provisions on Live Streaming Service (互联网直播服务管理规定) (the “CAC Live Streaming Rules”), which became effective on December 1, 2016. The very next day, on December 2, 2016, MOC issued the Administrative Measures on Online Performance Business Operation (网络表演经营活动管理办法) (the “MOC Online Performance Rules”), which became effective on January 1, 2017. The CAC Live Streaming Rules focus on live online streaming only, whereas the MOC Online Performance Rules apply to both live online streaming and to recorded videos that are uploaded online.

The MOC Online Performance Rules require operating units that provide online broadcasting products or services to the public by way of fees and ecommerce (the “Online Performance Operating Units”)<sup>171</sup> to obtain internet culture operation licenses, which is the same license that MOC issues in connection with the operation of online games.<sup>172</sup> As noted above, because MOC does not accept applications for internet culture operation licenses from foreign companies or foreign-invested companies, the MOC Online Performance Rules make it clear that China’s long standing prohibition on foreign investment in companies engaged in internet culture activities extends to companies that provide live online streaming services.<sup>173</sup> The CAC Live Streaming Rules also emphasize that any provider of internet live-streaming services shall obtain the relevant required licenses.<sup>174</sup>

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<sup>170</sup> See “[Mobile E-Sports Games in China Represent 24% of Top Grossing Titles on Android](#)”, posted at Newzoo on February 15, 2016.

<sup>171</sup> CAC uses the term “live streaming service provider (网络直播服务提供商)”, but based on our reviewing the rules, Online Performance Operating Unit is the same as live streaming service provider

<sup>172</sup> See Section 4 of the Administrative Measures on Online Performance Business Operation (网络表演经营活动管理办法), issued by MOC on December 2, 2016 (the “MOC Online Performance Rules”).

<sup>173</sup> See Article 4 of the Several Opinions on the Introduction of Foreign Investment in Cultural Fields (关于文化领域引进外资的若干意见), issued by the Ministry of Culture on July 6, 2005.

<sup>174</sup> See Sections 5 and 6 of the Administrative Provisions on Live Streaming Service (互联网直播服务管理规定), issued by CAC on November 4, 2016 (the “CAC Live Streaming Rules”).

Both the MOC Online Performance Rules and CAC Live Streaming Rules place most of the responsibility of ensuring that live streaming content complies with China's strict censorship rules onto the Online Performance Operating Units and providers of such live streaming content. Such responsibilities include reviewing non-real-time content before it is published, ensuring that a sufficient number of content reviewers are employed, real-time monitoring of live-streaming content and ensuring that technical measures are in place to instantly cut-off internet live-streams if the streamed content violates applicable laws or regulations. In addition, all online performances must be recorded and stored for at least sixty (60) days, and provided to the relevant authorities upon request. Online Performance Operating Units are also required to submit content review reports to MOC on a quarterly basis, including the results of real-time monitoring and a name list of performers who provide any content that violates applicable laws or regulations.

Both rules require the verification of online performers' real identities. If an online performer is an individual, such performer must submit a copy of his or her national identification card to the Online Performance Operating Unit, who is responsible for verifying the identity of the performer through one or more in-person interviews or recorded phone or video calls.<sup>175</sup> The CAC Live Streaming Rules also require online performers to register their real identity with the provincial level offices of CAC.<sup>176</sup> These additional details regarding implementation of real-name registration for online performers, in conjunction with the fact that there should naturally be far fewer performers than there are viewers, suggests that this requirement for online performers to register their real-name in connection with their online performances is likely to be enforced.

Starting on March 15, 2017, an Online Performance Operating Unit must first submit an application to the Ministry of Culture and obtain special approval before such Online Performance Operating Unit can open a live performance channel, or make available to the public the performance works, of a foreign performer (including performers from Hong Kong, Macao or Taiwan).<sup>177</sup> In the context of domestic performers, Online Performance Operating Units must now register the channel with the Ministry of Culture within ten (10) days after first making the channel available to the public.<sup>178</sup> This difference in censorship treatment for foreign content and domestic content is similar to MOC's approach to video game approvals, where MOC approval must be obtained in advance of publishing a foreign video game, while a domestic video game need only be registered with MOC within thirty (30) days after initial publication.<sup>179</sup>

#### **8.4 Government Incentives**

In addition to various restrictions imposed on the online game industry, regulators have also experimented with policies designed to guide the development of online games that are regarded as beneficial for society. Many domestic online game operators and developers

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<sup>175</sup> See Section 9 of the MOC Online Performance Rules.

<sup>176</sup> See Section 12 of the CAC Live Streaming Rules.

<sup>177</sup> See Sections 10 and 22 of the MOC Online Performance Rules.

<sup>178</sup> See Section 10 of the MOC Online Performance Rules.

<sup>179</sup> See Sections 11 and 13 of the Interim Provisions on the Administration of Online Games.

in China also benefit from preferential tax treatment provided to companies that qualify as high and new technology enterprises.

In 2004, SAPPRFT launched the “Chinese Nationality Online Game Publication Project” (中国民族网络游戏出版工程), which is designed to encourage both the spread of Chinese culture among minors and the ability of domestic game companies to produce online games,<sup>180</sup> and to date, 194 online games have been recognized under the project.<sup>181</sup> At the PRC game industry’s annual meeting in December 2016, Sun Shoushan, the vice director of SAPPRFT, announced the launch of a new “China Original Boutique Game Publication Project” (中国原创精品游戏出版工程) that will support certain online games recognized under this boutique game project by providing special guidance and game approval priority, government funding, education training and other preferential policies in connection with such games.<sup>182</sup>

MOC has also at times encouraged the development of China’s digital game industry and other related industries by supporting, for example, the development of both e-sports,<sup>183</sup> and “green games”, which are games that are suitable for minors (适合未成年人的网络游戏).<sup>184</sup> In August 2005, January 2006, and February 2008, for example, MOC released lists of games that the content censorship committee regarded as suitable for minors.<sup>185</sup> In connection with at least one such game, however, MOC discovered that online games are not static entertainment properties that retain their original form for the duration of their existence, and stopped issuing such lists of officially approved green games. The relevant game, which is entitled “Jin Wu Tuan” (劲舞团), was on the official list of approved green games in 2005. Thereafter, Jiu You, the company responsible for Jin Wu Tuan, incorporated content and functionality that violated content regulations into the game, such as an interactive function called “reserve a room to dance” (开房跳舞) and a marriage function, both of which encouraged players to establish sexual relationships with other players in the real world.<sup>186</sup> When this was discovered in 2008, MOC publicly criticized Jiu You for its poor behavior, ordered Jiu You to address such issues in the game, and no list of officially approved green games has been released since then.

In connection with our informal inquiries, MOC has indicated that it does not intend to establish any special incentive plans for the development of green games, believing that the most effective way to promote green games is through the establishment and enforcement of proper content regulations. In a broader context, MOC has also indicated that it does not intend to recognize or otherwise support particular game projects, and although MOC

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<sup>180</sup> See Article 1 of the Notice Regarding the Implementation of the Chinese Nationality Online Game Publication Project (关于实施“中国民族网络游戏出版工程”的通知), issued by SAPPRFT on August 3, 2004.

<sup>181</sup> See “[Disclosure of the Tenth Series of Chinese Nationality Online Game Publication Project](#)” (第十批“中国民族网络游戏出版工程”项目名单公布) (Chinese), posted at [game.people.com.cn](#) on February 18, 2015.

<sup>182</sup> See “[Vice Director of SAPPRFT: Promote PRC Game Publishing Industry to a New Level](#)” (广电总局副局长孙寿山：推动中国游戏出版产业上新台阶) (Chinese), posted at [game.china.com](#) on December 15, 2016.

<sup>183</sup> See Article 5 of the Opinion of Promoting Culture and Entertainment Industry Transformation and Upgrading.

<sup>184</sup> See “[Ministry of Culture Solicits Online Games for Minors](#)”, posted at [china.org.cn](#) on July 10, 2005.

<sup>185</sup> See “[Ministry of Culture Solicits Online Games for Minors](#)”, posted at [china.org.cn](#) on July 10, 2005.

<sup>186</sup> See “[MOC Criticizes Jin Wu Tuan, Jiu You Public Relationship Department was Forbidden to Talk](#)” (文化部通报批评《劲舞团》久游网公关部被封口) (Chinese), posted at [Sohu.com](#) on July 15, 2008.

encourages the international expansion of China's online game industry, MOC does not currently intend to adopt specific policies in support of such expansion.

Online game companies may be eligible, however, to receive preferential tax treatment from the PRC government. The primary tax preferences that online game companies in China often qualify for are those for high and new technology enterprises. The current corporate income tax rate in China is 25%, but companies that obtain high and new technology enterprise status, which is reassessed every three years, are subject to a corporate income tax rate of only 15%.<sup>187</sup> The qualification requirements for high and new technology enterprises are set forth in Annex VII.

In addition, in order to attract investment to northwest China during the period between 2010 and 2020, each company whose principal business falls within the scope of encouraged industries, which includes the digital game industry, that establishes in Kashi or Horgos, two cities in China's Xinjiang province,<sup>188</sup> is exempt from paying corporate income tax for five (5) years beginning as of the first year such company starts making profit.<sup>189</sup>

*[Annexes Follow]*

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<sup>187</sup> Article 28 of the Income Tax Law of PRC (企业所得税法), issued by the National People's Congress on March 16, 2007, and Article 12 of Administrative Measures for the Determination of High and New Tech Enterprises (高新技术企业认定管理办法), issued by Ministry of Science and Technology (科技部), Ministry of Finance (财政部) and State Administration of Taxation on January 29, 2016.

<sup>188</sup> Detail encouraged industries shall refers to the Notice on the Improvement of the Preferential List of Income Tax Preferential for the Enterprises in Encouraged Industry in Xinjiang Difficult Areas (关于完善新疆困难地区重点鼓励发展产业企业所得税优惠目录的通知), issued by the Ministry of Finance and other four department on September 2, 2016.

<sup>189</sup> See Article 6, Section 3 of Several Opinions of the State Council on Supporting the Construction of Kashi Horgos Economic Development Zone (国务院关于支持喀什霍尔果斯经济开发区建设的若干意见), issued by the State Council on October 8, 2011.

PEOPLE'S REPUBLIC OF CHINA  
GOVERNMENT ORGANIZATIONAL STRUCTURE<sup>190</sup>



<sup>190</sup> Source: [China Communist Party News website](#), and [National People's Congress website](#).



**MINISTRY OF CULTURE**  
**ORGANIZATIONAL STRUCTURE**  
 (文化部)<sup>192</sup>



The Department of Cultural Market is in charge of online game supervision, and issuing internet culture operation licenses.<sup>193</sup> There are five divisions inside the Department of Cultural Market, consisting of: the General Office (办公室), the Integrated Law Enforcement Division (综合执法办公室), the Law Enforcement and Guidance Division (执法指导监督处), the Entertainment, Performance and Artwork Market Division (娱乐演出艺术品市场管理处) and the Internet Culture Division (网络文化处). The Internet Culture Division is responsible for the foreign game approvals and the domestic game registrations.

<sup>192</sup> Source: [MOC website](#).

<sup>193</sup> Source: [China Culture Market website](#).

**THE STATE ADMINISTRATION OF PRESS, PUBLICATION, RADIO, FILM AND TELEVISION ORGANIZATIONAL STRUCTURE**  
(国家新闻出版广电总局)<sup>194</sup>



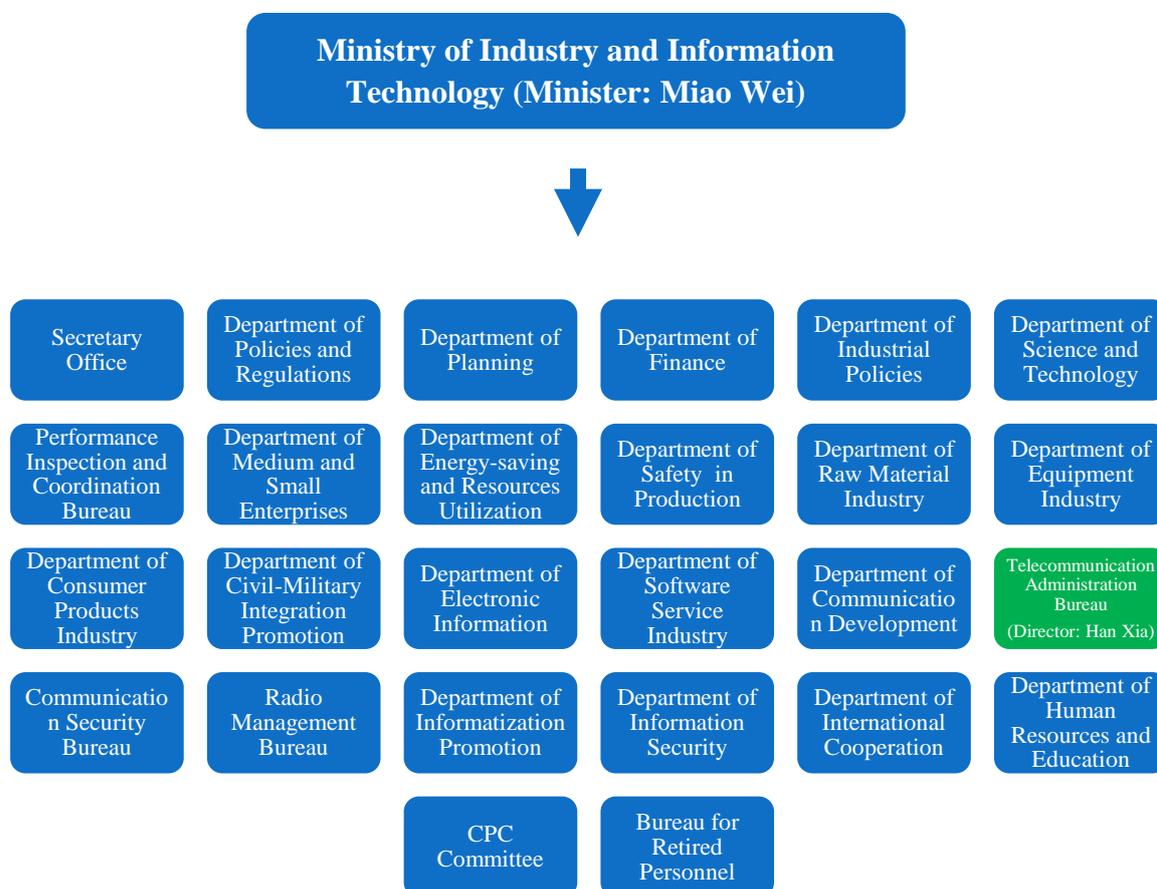
The Department of General Affairs (综合业务司) is in charge of issuing internet publishing licenses.<sup>195</sup> The Department of Digital Publication (数字出版司) is in charge of supervising online publishing service providers and online game publication. This department is also in charge of foreign and domestic game approvals.<sup>196</sup>

<sup>194</sup> Source: [SAPPRFT website](#).

<sup>195</sup> Source: [SAPPRFT website](#).

<sup>196</sup> Source: [SAPPRFT website](#).

**THE MINISTRY OF INDUSTRY AND INFORMATION TECHNOLOGY**  
**ORGANIZATIONAL STRUCTURE**  
 (工业和信息化部)<sup>197</sup>



The Telecommunication Administration Bureau (电信管理局) is in charge of the administration of internet domain names, internet protocol addresses, and telecommunication and information services.<sup>198</sup> Application for the value-added telecommunication license required to operate online games in China is, however, approved at the provincial level offices of MIIT rather than at the central office in Beijing.<sup>199</sup>

<sup>197</sup> Source: [MIIT website](#).

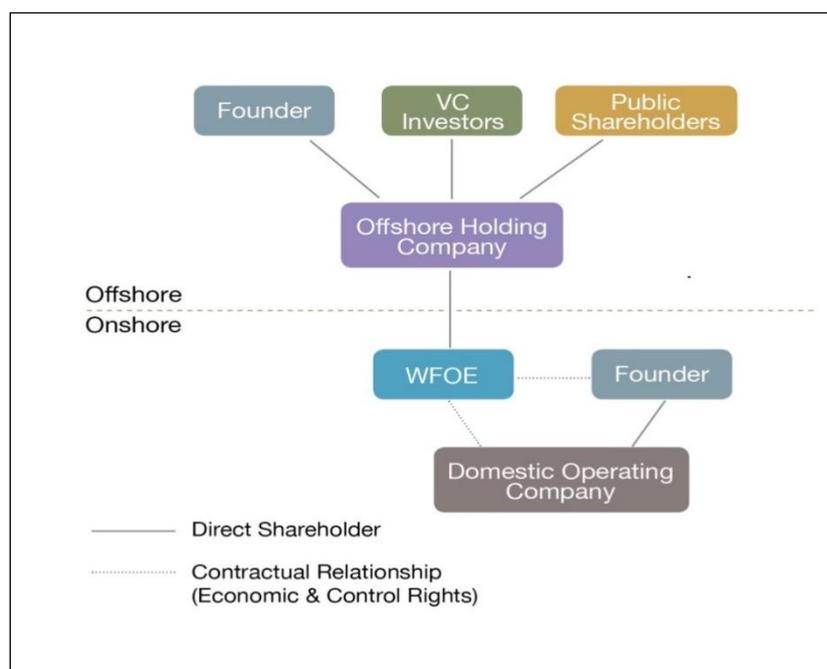
<sup>198</sup> Source: [MIIT website](#).

<sup>199</sup> See Article 7 of the Administrative Measures on Internet Information Services.

## CHINA VARIABLE INTEREST ENTITY (VIE) STRUCTURE OVERVIEW

As noted under Section 2.2 (Foreign Ownership Restrictions), foreign investment in China’s digital game industry is prohibited. Notwithstanding these foreign investment restrictions, many of China’s domestic online game operators have received financing from foreign venture capital funds and listed their shares on overseas stock exchanges. Such companies have achieved what they believe to be technical compliance with the foreign ownership restrictions by establishing a variable interest entity (“VIE”) structure in which the foreign-invested entity does not have a direct ownership interest in the domestic operating company that holds the licenses required to operate online games in China.

The foreign-invested entity generally is a wholly foreign-owned enterprise (“WFOE”) that is a subsidiary of an offshore holding company, in which the original founders, the venture capital investors and the public shareholders invest. Although the WFOE does not have a direct equity interest in the domestic operating company, the WFOE does control the operating company through a series of contractual relationships with both the operating company and the operating company’s nominee shareholders, which are often the company founders, relatives of the founder or trusted employees. In addition, the WFOE generally enters into a consulting agreement with the operating company pursuant to which the WFOE extracts substantially all of the operating company’s profits.



Although the contractual relationships among the WFOE, the operating company and the operating company’s shareholders vary from one online game operator to another, these contractual relationships generally include, or should include, the features summarized below.

- (1) Purchase Option. The WFOE generally has a right to purchase the shares of the operating company from its nominee shareholders once such a purchase is permitted by applicable law.
- (2) Control Rights. The WFOE is generally able to exercise control over the operating company through agreements with the shareholders of the operating company or with the operating company directly, such as a voting rights agreement, a proxy, or a power of attorney. The VIE structures of some companies use more than one form of control rights agreement.
- (3) Revenue Agreements. The WFOE generally enters into one or more agreements with the operating company that permit the WFOE to extract substantially all of the profits from the operating company, such as a consulting agreement, a technical service agreement, and a variety of copyright license agreements. The fees charged under these agreements are generally not fixed amounts, but vary depending upon costs incurred, revenue generated or some other set of variables.
- (4) Loan Agreement. In situations where the operating company requires additional capital investment, the WFOE often enters into loan agreements with the nominee shareholders of the operating company and the shareholders then use the loaned funds to increase the registered capital of the operating company. If, however, the WFOE is newly established company, in accordance with the usage restrictions on WFOE registered capital required by the State Administration of Foreign Exchange, the bank might not permit the WFOE to provide a loan with its registered capital.<sup>200</sup> As a result, the parties might need to explore other funding mechanisms, such as direct investment into the operating company by one or more current or new nominee shareholders.
- (5) Equity Pledge. The nominee shareholders of the operating company generally pledge their shares to the WFOE to guarantee the operating company's compliance with the terms of the revenue agreements and, if relevant, the nominee shareholders' compliance with the terms of the loan agreements. Pursuant to the share pledge agreement the nominee shareholders generally covenant not to sell their shares to any third party or to permit any encumbrance upon their shares.
- (6) Spouse Consent Letter. Any nominee shareholder that is married at the time he receives his equity interest in the operating company, or later becomes married, should have his spouse execute a spouse consent letter. This spouse consent letter should confirm that the equity interest of the operating company is the separate property and personal asset of the nominee shareholder, and that if the spouse inadvertently obtains any right to such equity interest then the various VIE agreements executed by the nominee shareholder shall also bind the spouse. Prior to 2011 when Tudou's initial public offering was delayed as a result of the founder's divorce proceedings and an attempt by his spouse to obtain an ownership interest in

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<sup>200</sup> See Article 2 of the Circular of the State Administration of Foreign Exchange on Reforming the Management Approach regarding the Settlement of Foreign Exchange Capital of Foreign-invested Companies (国家外汇管理局关于改革外商投资企业外汇资本金结汇管理方式的通知), issued by the State Administration of Foreign Exchange (国家外汇管理局) on March 30, 2016.

Tudou's operating company, this risk was not well understood. Accordingly, many current VIE structures do not include a spouse consent letter.<sup>201</sup>

Although this VIE structure has been in use since the first China internet companies listed their shares on NASDAQ in 2000,<sup>202</sup> there are certain risks associated with the structure. For example, the nominee shareholders of the operating company are often the original founders, their family members or their trusted employees. If a conflict arose between these nominee shareholders and the management of the offshore holding company, the nominee shareholders could attempt to challenge the validity of the various control contracts.<sup>203</sup> Since the control contracts do not comply with the spirit of the foreign ownership restrictions, a court in China may find that the control contracts are not enforceable. In addition, MOC, SAPPRFT or MIIT could determine that the VIE structure violates the foreign ownership restrictions and terminate the licenses held by the operating company that are required in order to operate online games in China.

In addition to these risks and others listed in the disclosure documents of the various online game companies with shares listed on overseas stock exchanges, the VIE structure is also tax inefficient. All of the profits that are extracted from the operating company by the WOFE through consulting agreement fees are subject to a 6% value-added tax.<sup>204</sup>

Although the VIE structure has advanced the development of China's internet industry by facilitating foreign venture capital investments and overseas public offerings, this same structure is generally not regarded as a viable means for foreign internet companies and online game operators to enter China's domestic market. Some foreign companies have used the VIE structure to enter China's domestic market for internet culture activities and internet publishing, but they have generally done so in a very low profile manner with careful consideration given to the branding of the domestic operating company's service platform. High profile foreign companies generally do not view the VIE structure as a viable way to enter China's domestic online game operations market. Amazon.com, Inc, however, announced in 2012 that its operations in China were conducted through a VIE, which suggests that at least one high profile foreign company had entered restricted sectors of China's economy through the use of this structure.<sup>205</sup>

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<sup>201</sup> For a discussion of the nominee shareholder's spouse risk factors, see "[Tudou IPO Exposes Yet Another China Risk Factor: the Founder's Wife](#)", by Greg Pilarowski on August 19, 2011 at the New York Times, via Venture Beat.

<sup>202</sup> Sina, NetEase and Sohu completed their initial public offerings, listing their securities on NASDAQ, in April, June and July of 2000, respectively. All three companies used a VIE structure to complete their initial public offerings.

<sup>203</sup> See "[GigaMedia will Survive Current VIE Turmoil](#)", posted at Seeking Alpha on June 3, 2011, for a summary of GigaMedia's loss of control over its VIE Shanghai T2 Entertainment. For an example of a failed VIE outside of the internet sector, see this [Form 8-K](#) filed with the Securities and Exchange Commission by Buddha Steel Inc. on March 28, 2011. See "[Getting to the Bottom of the Alipay Dispute](#)", posted at Caixin Online on June 24, 2011, for a summary of the unilateral decision of Alibaba's founder Jack Ma to terminate the VIE structure agreements through which Alibaba controlled Alipay, one of the largest online payment platforms in China.

<sup>204</sup> See Notice to Implement Change from Business Tax to Value-Added Tax Pilot Zone Management Nationally (关于在全国开展营业税改征增值税试点有关征收管理问题的公告), issued by State Administration of Taxation (国家税务总局) on July 10, 2013.

<sup>205</sup> See "[MNCs and VIEs](#)" by Paul Gillis at chinaaccountingblog.com. See also page 32 of Amazon's report on Form 10Q for the quarter ended June 30, 2012, at the [SEC website](#).

## Supreme People's Court Considers the VIE

On July 2, 2016, the Supreme People's Court of China (the "Supreme Court") issued a decision related to the VIE structure, which may provide some comfort to the investors in a VIE structure since the court was invited to consider the validity of VIE agreements and to invalidate them for violating PRC law, but the court declined to do so. Although the decision didn't affirm the validity of VIE agreements, the Supreme Court's decision to not invalidate the VIE structure suggests that there is an understanding of the harm that invalidating the structure would likely cause to the many PRC businesses that rely upon this structure for foreign investment and overseas stock exchange listings. Below please find a summary of the key facts the case and relevant holdings in the Supreme Court decision.

Ambow Education Holding Ltd., a Company established under the laws of the Cayman Islands ("Ambow Cayman"), owns one hundred percent (100%) of Beijing Ambow Online Software Co., Ltd (北京安博在线软件公司), a wholly foreign-owned entity established under the laws of the PRC ("Ambow WFOE"). Through a VIE structure, Ambow WFOE controls Beijing Normal University Ambow Education Technology Co., Ltd. (北京师大安博教育科技有限公司), a domestic company established under the laws of the PRC with two PRC citizens as nominee shareholders ("Ambow Domestic Company").

In 2009, Hunan Changsha Yaxing Property Development Co., Ltd (长沙亚兴置业发展有限公司) ("Yaxing"), the plaintiff, entered into a cooperation framework agreement (the "Framework Agreement") with Ambow Domestic Company, pursuant to which Yaxing sold a kindergarten to Ambow Domestic Company in exchange for cash along with stock issued by Ambow Cayman. In 2010, after the Yaxing deal closed, Ambow Cayman completed its initial public offering and New York Stock Exchange listing. In 2012, however, Ambow Cayman's stock price collapsed, and subsequently the company was delisted, which resulted in Ambow Cayman's stocks becoming largely worthless.

Unhappy with this outcome, Yaxing brought a lawsuit against Ambow Domestic Company in the Hunan Province Higher People's Court (湖南省高级人民法院), claiming that the Framework Agreement was null and void because it is illegal for Ambow Domestic Company to own a kindergarten. Yaxing argued that (i) Ambow WFOE controlled Ambow Domestic Company through various VIE agreements, and therefore Ambow Domestic Company should be deemed to be a foreign-invested company; and (ii) the Framework Agreement shall be deemed void because it violates various mandatory requirements under "PRC laws and regulations", including the Guidance of Foreign Investment Industries (外商投资产业指导目录), pursuant to which foreign-invested companies are prohibited from providing compulsory education services, such as operating a kindergarten.

Hunan Province Higher People's Court, however, decided in favor of Ambow Domestic Company. Yaxing appealed to the Supreme Court, but the Supreme Court affirmed the Hunan Province Higher People's Court's decision. The Supreme Court decision held as follows:

(i) Although a VIE structure exists, Ambow Domestic Company shall not be deemed as a foreign-invested company because Ambow WFOE is not a shareholder of Ambow Domestic Company and none of Ambow Domestic Company's shareholders are foreigners. The source of the funds that shareholders used to pay the registered capital of a

company is not relevant when determining what of a company the recipient of the registered capital is. The relevant factor is the identity and nature of the shareholders, not the ultimate source of registered capital funds.

(ii) Although it is correct that a contract can be voided if it violates mandatory requirements under “PRC laws and regulations”<sup>206</sup>, “PRC laws and regulations” only refers to the laws and regulations issued by the National People’s Congress (“NPC”), the Standing Committee of the NPC, or the State Council, and does not refer to local rules or other administrative rules. The Guidance of Foreign Investment Industries (外商投资产业指导目录) is an administrative rule promulgated by the National Development and Reform Commission and the Ministry of Commerce. As a result, the Framework Agreement is not deemed void due to the violation of the Guidance of Foreign Investment Industries.

Although the Supreme Court did not hold the Framework Agreement void, the decision also does not constitute formal judicial recognition of the VIE structure. In the holding, the Supreme Court stated that “whether or not the VIE agreements are valid is not an issue in dispute between Yaxing and Ambow Domestic Company, and therefore this issue will not be decided by this court”. In addition, in the holding, the Supreme Court suggested that the Ministry of Education (教育部) should take measures to punish any illegal activities in this field through administrative actions.

## **Proposed Foreign Investment Law**

Other government authorities, such as MOFCOM, have also struggled with the validity of the VIE structure. In the draft of the proposed Foreign Investment Law (中华人民共和国外国投资法 (草案征求意见稿)) that MOFCOM published for commentary on January 19, 2015 (the “Draft FIL”), MOFCOM introduced the “actual control” principal as a classification method to determine whether a company in China is to be classified as foreign or domestic, and provided that a company under the control of one or more foreign natural persons or entities will be treated as a foreign company.<sup>207</sup> The term “control” was defined to include any of the following: (1) holding equity ownership over 50%; (2) having a right to appoint a majority of board members, ensuring its nominee can occupy a majority of the board seats or exerting a significant impact on board or shareholder resolutions; or (3) having significant influence over the company’s management, finances or personnel through contract or trust.<sup>208</sup> Implementation of the “actual control” approach in the context of foreign investment classification suggests that MOFCOM is trying to prevent foreigners from evading China’s foreign investment restriction through the use of the VIE structure. As such, we suspect the validity of the VIE structures for many PRC companies listed on foreign stock exchanges to be called into question if the Draft FIL is adopted in its current form. As of April 2017, however, there is still no clear signal that MOFCOM will adopt the Draft FIL any time soon, which suggests that the PRC government is unlikely to invalidate, on short notice, the VIE structure because of the material damage that this could cause to many of China’s leading internet companies, including Tencent and NetEase.

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<sup>206</sup> See Article 52, Section 5 of PRC Contract Law (中华人民共和国合同法), issued by the Standing Committee of the National People’s Congress in March 15, 1999.

<sup>207</sup> See Article 11 of the Foreign Investment Law (Draft for Public Comments) (中华人民共和国外国投资法 (草案征求意见稿)), issued by MOFCOM on January 19, 2015 (the “Draft FIL”).

<sup>208</sup> See Article 18 of the Draft FIL.

## ONLINE GAME PUBLISHER PAGES

<b>PRC Game Publisher</b>
Tencent (腾讯)
Netease (网易)
Giant (巨人)
Shanda Games (盛大)
Changyou (畅游)
Perfect World (完美世界)
KongZhong (空中)
iDreamSky (乐逗游戏)
NetDragon (网龙)
YY (欢聚时代)
Qihu 360 (奇虎 360)
Yodo1 (游道易)
Kunlun (昆仑万维)
KingSoft (金山公司)
37 Games (37 游戏)
Youzu (游族网络)

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## TENCENT HOLDINGS LTD.



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### Profile:

Date of Incorporation:	November 1998
Founder:	Ma Huateng (马化腾)
Public/Private:	HKSE: 0700.HK
Total Revenue <sup>209</sup> :	US\$21.9 billion (for year ended December 31, 2016)
Market Capitalization:	HKD2.15 trillion (equivalent of approximately US\$276.6 billion <sup>210</sup> as of April 10, 2017)
Website:	<a href="http://www.tencent.com">http://www.tencent.com</a>
Sample Published Games:	<ul style="list-style-type: none"><li>- PC Online Games: <a href="#">Legal of Legend (英雄联盟)</a>, <a href="#">Dungeon-Fighter (地下城与勇士)</a>, <a href="#">NBA2K Online</a>, <a href="#">FIFA Online 3</a> and <a href="#">Call of Duty (使命召唤)</a></li><li>- Mobile Games: <a href="#">King Glory (王者荣耀)</a>, and <a href="#">Candy Crush (糖果传奇)</a></li></ul>

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### Company Description:

Tencent Holdings Limited (“Tencent”) is a leading provider of internet value-added services in China, as well as the largest game company in the world. Tencent’s diverse services include social networks, web portals, e-commerce, and multiplayer online games. Tencent’s leading internet platforms in China – Tencent QQ, Weixin/WeChat, QQ.com, Tencent Games, Qzone, and Tenpay – have brought together China’s largest internet community, to meet the various needs of internet users including communication, information, entertainment, financial services and others.

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### Address:

Tencent Building, Kejizhongyi Avenue,  
Nanshan District, Shenzhen 518057, People’s Republic of China

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<sup>209</sup> For the purpose of this Annex III-A (Online Game Publisher Pages), “Total Revenue” refers to the actual top line earning of the company.

<sup>210</sup> Based on the currency exchange rate issued by [Bloomberge Markets](#) on April 10, 2017 of US\$1 = HKD7.7702 (the “HKD Exchange Rate”).

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NETEASE, INC.

**網易 NETEASE**  
**www · 163 · com**

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**Profile:**

Date of Incorporation: June 1997  
Founder: Ding Lei (丁磊)  
Public/Private: NASDAQ: NTES  
Total Revenue: US\$5.5 billion (for year ended December 31, 2016)  
Market Capitalization: US\$36.92 billion (as of April 10, 2017)  
Website: <http://www.netease.com>  
Sample Published Games: – PC Online Games: [World of Warcraft \(魔兽世界\)](#), [Diablo III \(暗黑破坏神 3\)](#), [Hearthstone \(炉石传说\)](#) and [Overwatch \(守望先锋\)](#)  
– Mobile Games: [Onmyoji \(阴阳师\)](#), [Fantasy Westward Journey \(梦幻西游\)](#), [A Chinese Odyssey \(大话西游\)](#), [Minecraft \(我的世界\)](#), [World of Tank Blitz \(坦克世界闪击战\)](#) and [Raven \(掠夺者\)](#)

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**Company Description:**

NetEase, Inc (“NetEase”) is a leading internet technology company in China. Dedicated to providing online services centered around content, community, communication and commerce, NetEase develops and operates some of China’s most popular PC online games and mobile games, advertising services, e-mail services and e-commerce platforms. In partnership with Blizzard Entertainment, Mojang AB (a Microsoft subsidiary) and other global game developers, NetEase operates some of the most popular international PC online games in China, and NetEase has also achieved marked success in the mobile games market, both with self-developed titles and with licensed games.

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**Address:**

NetEase Building, No.16 Keyun Road,  
Tianhe District, Guangzhou 510665, People’s Republic of China

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**GIANT NETWORK GROUP CO., LTD.**

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**Profile:**

Date of Incorporation:	November 2004
Founder:	Shi Yuzhu (史玉柱)
Public/Private:	SZ002558 <sup>211</sup>
Total Revenue:	RMB2.324 billion (equivalent of approximately US\$336.61 million <sup>212</sup> for year ended December 31, 2016)
Market Capitalization:	RMB5.327 billion (equivalent of approximately US\$771.56 million <sup>213</sup> as of April 10, 2017)
Website:	<a href="http://www.ga-me.com">http://www.ga-me.com</a>
Sample Published Games:	<ul style="list-style-type: none"><li>– PC Online Games: <a href="#">ZT Online (征途)</a>, <a href="#">ZT Online 2 (征途 2)</a> and <a href="#">World of Xianxia (仙侠世界)</a></li><li>– Mobile Game: <a href="#">Battle of Balls (球球大作战)</a>, <a href="#">Street Basketball (街篮)</a> and <a href="#">Vainglory (虚荣)</a></li></ul>

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**Company Description:**

Giant Network Group Co., Ltd. (“Giant”) is one of China’s leading online game developers and operators in terms of market share. Giant mainly focuses on massively multiplayer online games, but has also expanded into developing and operating mobile games.

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**Address:**

No. 655, Zhongchen Road,  
Songjiang District, Shanghai 201603, People’s Republic of China

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<sup>211</sup> Giant was a public company listed on NYSE (NYSE: GA) and went private in July 2014. In March 2017, Giant merged with a shell company called Chongqing New Century Cruises Co., Ltd (重庆新世纪游轮股份有限公司) (SZ002558) and listed on China’s Shenzhen Stock Exchange by reverse merger. On April 5, 2017, Century Cruises announced that the company would change its name to “Giant Network Group Co., Ltd (巨人网络集团股份有限公司)”.

<sup>212</sup> Based on the middle currency exchange rate published by the [Bank of China \(中国银行\)](#) on April 10, 2017 of US\$1 = RMB6.9042 (“RMB Exchange Rate”).

<sup>213</sup> Based on RMB Exchange Rate.

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## SHANDA GAMES



盛大游戏™

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### Profile:

Date of Incorporation:	November 1999
Founder:	Chen Tianqiao (陈天桥) <sup>214</sup>
Public/Private:	Private Company <sup>215</sup>
Total Revenue:	RMB3.86 billion (equivalent of approximately US\$559.08 million <sup>216</sup> for year ended December 31,2016) <sup>217</sup>
Market Capitalization:	N/A
Website:	<a href="http://www.shandagames.com">http://www.shandagames.com</a>
Sample Published Games:	<ul style="list-style-type: none"><li>– PC Online Games: <a href="#">Legend of Mir II (热血传奇 II)</a>, <a href="#">World of Legend (传奇世界)</a>, <a href="#">The Light of Town (地城之光)</a> and <a href="#">Final Fantasy XIV (最终幻想)</a></li><li>– Mobile Games: <a href="#">Dragon Nest (龙之谷)</a></li></ul>

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### Company Description:

Shanda Games develops, sources, and operates online games in the China. Shanda Games is a leading interactive entertainment media company with more than 2000 research, development and operation staff. Shanda Games offers massively multi-player online role-playing games in various genres and also operates mobile games for smartphones and tablets.

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### Address:

No.1 Office Building, No. 690 Bibo Road,  
Pudong District, Shanghai 201203, People's Republic of China

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<sup>214</sup> Chen Tianqiao sold all of his shares of Shanda Games in November 2014, and he no longer has any interest in the company.

<sup>215</sup> Shanda Games was a public company listed on NASDAQ (NASDAQ: GAME) and went private in November 2015. Zhejiang Century Huatong Group Co., Ltd (浙江世纪华通集团股份有限公司), a public company listed on Shenzhen Stock Exchange ("Century Huatong"), owns 90.92% of Shanda Games.

<sup>216</sup> Based on RMB Exchange Rate.

<sup>217</sup> Total net revenue data of Shanda Games is from a public release of Century Huatong on January 11, 2017.

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**CHANGYOU.COM LIMITED**

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**Profile:**

Date of Incorporation:	June 2003
Founder:	Zhang Caoyang (张朝阳)
Public/Private:	NASDAQ: CYOU
Total Revenue:	US\$525 million (for year ended December 31, 2016)
Market Capitalization:	US\$1.45 billion (as of April 10, 2017)
Website:	<a href="http://www.changyou.com">http://www.changyou.com</a>
Sample Published Games:	<ul style="list-style-type: none"><li>- PC Online Games: <a href="#">New Demi Gods and Demi Devils (新天龙八部)</a>, <a href="#">Water Margin (大话水浒)</a>, and <a href="#">Blade on Line (刀剑英雄)</a></li><li>- Mobile Games: <a href="#">Demi Gods and Demi Devils (天龙八部)</a>, and <a href="#">The Storm (风云)</a></li></ul>

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**Company Description:**

Changyou.com Limited (“[Changyou](#)”) is a leading developer and operator of online games in China with a diverse portfolio of popular online games. Changyou also owns and operates the 17173.com website, a leading game information portal in China. Changyou began operations as a business unit within Sohu.com Inc. (NASDAQ: SOHU) in 2003, and was carved out as a separate, stand-alone company in December 2007. Changyou has an advanced technology platform that includes advanced 2.5D and 3D graphics engines, a uniform game development platform, effective anti-cheating and anti-hacking technologies, proprietary cross-networking technology and advanced data protection technology.

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**Address:**

Building B of Changyou Mansion, No.65 Bajiao East Street,  
Shijingshan District, Beijing 100043, People’s Republic of China

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**PERFECT WORLD CO., LTD.**

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**Profile:**

Date of Incorporation: March 2004  
Founder: Chi Yufeng (池宇峰)  
Public/Private: SZ002624<sup>218</sup>  
Total Revenue: RMB6.159 billion (equivalent of approximately US\$892.07 million<sup>219</sup> for year ended December 31, 2016)  
Market Capitalization: RMB38.23 billion (equivalent of approximately US\$5.54 billion<sup>220</sup> as of April 10, 2017)  
Website: <http://www.wanmei.com/>  
Sample Published Games:

- PC Online Games: [DOTA 2 \(刀塔 2\)](#), [Perfect World \(完美世界\)](#), [CS: GO](#), and [NeverWinter \(无冬之夜 Online\)](#)
- Mobile Games: [Zhu Xian \(诛仙手游\)](#), [Return of the Condor Heroes\(神雕侠侣\)](#) and [Torchlight \(火炬之光\)](#)

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**Company Description:**

Perfect World Co., Ltd. (“Perfect World”) is a globalized entertainment company. Through its subsidiaries, Perfect World operates as an online game developer and operator internationally. Relying on strong technical strengths, innovative design capabilities, profound understanding of different cultures, and rich marketing experiences, Perfect World has launched several well-received games. Starting from client games, the company has successively expanded to web games, mobile online games, console games and VR games. Perfect World is also involved in other business segments including movies & TV, animation, comics, literature, media, and education.

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**Address:**

Perfect World Plaza, Building 306, 86 Beiyuan Road,  
Chaoyang District, Beijing 100101, People’s Republic of China

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<sup>218</sup> Perfect World was a public company listed on NASDAQ (NASDAQ: PWRD) and went private in August 2015.

<sup>219</sup> Based on RMB Exchange Rate.

<sup>220</sup> Based on RMB Exchange Rate.

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**KONGZHONG CORPORATION.**

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**Profile:**

Date of Incorporation:	May 2002
Public/Private:	Private Company <sup>221</sup>
Total Revenue:	US\$138.76 million (for three quarters ended September 30, 2016) <sup>222</sup>
Market Capitalization:	US\$349.51 million (as of April 10, 2017)
Website:	<a href="http://www.kongzhong.com">http://www.kongzhong.com</a>
Sample Published Games:	<ul style="list-style-type: none"><li>- PC Online Games: <a href="#">Guild Wars 2 (激战 2)</a>, <a href="#">Armageddon (大决战)</a>, <a href="#">World of Kungfu (功夫世界)</a>, and <a href="#">World of Tanks (坦克世界)</a></li><li>- Mobile Games: <a href="#">Pocket War (口袋战争)</a>, and <a href="#">Valkyrie Profile (女神战记)</a></li></ul>

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**Company Description:**

KongZhong Corporation (“KongZhong”) provides digital entertainment services in the People’s Republic of China. KongZhong operates through three segments: wireless value-added services, mobile games, and PC online games. Under PC online games, KongZhong operates the largest Chinese military gaming platform under the “WAR SAGA” brand, which includes games such as World of Tanks, World of Warplanes and World of Warships. On May 15, 2014, KongZhong officially launched 3D fantasy MMORPG Guild Wars 2 in China. KongZhong entered the smartphone game industry in 2011 through an acquisition of smartphone game engine and has expanded its mobile game development team across four cities across Mainland China.

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**Address:**

35<sup>th</sup> Floor, Tengda Plaza, No. 168 Xizhimenwai Street,  
Beijing 100044, People’s Republic of China

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<sup>221</sup> Kongzhong was a public company listed on NASDAQ (NASDAQ: KZ) and went private on April 14, 2017.

<sup>222</sup> Kongzhong has not released the Fourth Quarter 2016 Financial Results.

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## IDREAMSKY TECHNOLOGY LIMITED



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### Profile:

Date of Incorporation: 2009  
Founder: Chen Xiangyu (陈湘宇)  
Public/Private: Private Company<sup>223</sup>  
Total Revenue: N/A  
Market Capitalization: N/A  
Website: <http://www.idreamsky.com>  
Sample Published Games: – Mobile Games: [Temple Run \(神庙大逃亡\)](#), [Temple Run 2 \(神庙大逃亡 2\)](#), [Subway Sufers \(地铁酷跑\)](#), and [Fruit Nija \(水果忍者\)](#)

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### Company Description:

iDreamSky Technology Limited (“iDreamsky”) is a fast growing mobile game company and operates one of the largest independent mobile game publishing platforms in China. Through cooperating with the well-known international developers, iDreamsky managed to bring the most popular worldwide mobile games into China.

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### Address:

Floor 16, Building A3, Kexing Science Park, No. 15 Keyuan Road,  
Nanshan District, Shenzhen 518057, People’s Republic of China

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<sup>223</sup> iDreamsky was listed on NASDAQ (NASDAQ: DSKY), but went private on September 8, 2016.

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## NETDRAGON WEBSOFT HOLDINGS LIMITED



### Profile:

Date of Incorporation:	May 1999
Founder:	Liu Dejian (刘德建)
Public/Private:	HKSE: 0777.HK
Total Revenue:	RMB2.79 billion (equivalent of approximately US\$404.2 million <sup>224</sup> for year ended December 31, 2016)
Market Capitalization:	HKD10.99 billion (equivalent of approximately US\$1.41 billion <sup>225</sup> as of April 10, 2017)
Website:	<a href="http://www.netdragon.com/">http://www.netdragon.com/</a>
Sample Published Games:	<ul style="list-style-type: none"><li>- PC Online Games: <a href="#">Eumemons Online (魔域)</a>, and <a href="#">Conquer (征服)</a></li><li>- Mobile Games: <a href="#">Eumemos Online Mobile Version (魔域口袋版)</a>, and <a href="#">Wild Tribes (疯狂部落)</a></li></ul>

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### Company Description:

NetDragon Websoft Holdings Limited (“NetDragon”) is a leader in building internet communities and also develops, sources, and operates online games in China and in territories outside of China, such as the United States, Europe and the Middle East. NetDragon mainly focuses on massively multiplayer online games and mobile games.

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### Address:

851 Building, 58 Wen Quan Branch Road,  
Fuzhou 350001, People’s Republic of China

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<sup>224</sup> Based on RMB Exchange Rate.

<sup>225</sup> Based on HKD Exchange Rate.

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**YY INC.**

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**Profile:**

Date of Incorporation:	April 2005
Founder:	Li Xueling (李学凌)
Public/Private:	NASDAQ: YY
Total Revenue:	US\$1.18 billion (for year ended on December 31, 2016)
Market Capitalization:	US\$2.53 billion (as of April 10, 2017)
Website:	<a href="http://www.huanju.cn/">http://www.huanju.cn/</a>
Sample Published Games:	<ul style="list-style-type: none"><li>- PC Online Games: <a href="#">Battle of Red Cliff (赤壁之战)</a>, and <a href="#">Spirit Domain (灵域)</a></li><li>- Mobile Games: <a href="#">Jian Xia Wen Qing (剑侠问情)</a></li></ul>

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**Company Description:**

YY Inc. develops and operates a communication social platform in China, which enables users to participate in real-time online group activities through voice, video and text on PCs and mobile devices (the “YY Client”). YY Inc. operates web games through the game center on the YY Client. In July 2014, YY Inc. established “Huanju Game”, an independent online game publishing platform, to expand into massively multiplayer online games and mobile games.

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**Address:**

Floor 23-29, Wanda Plaza, No.368 Xingnan Avenue,  
Fanyu District, Guangzhou 511442, People’s Republic of China

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**QIHOO 360 TECHNOLOGY CO. LTD.**

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**Profile:**

Date of Incorporation:	June 2005
Founder:	Zhou Hongyi (周鸿祎)
Public/Private:	Private Company <sup>226</sup>
Total Revenue:	N/A
Market Capitalization:	N/A
Website:	<a href="http://www.360.cn/">http://www.360.cn/</a>
Published Games:	<ul style="list-style-type: none"><li>- PC Online Game: <a href="#">Anger Chop Army (怒斩千军)</a>, and <a href="#">Inexorable Doom of The Fairy (神仙劫)</a></li><li>- Mobile Games: <a href="#">Legend of Xiao Xiao Bing (小小冰传奇)</a>, <a href="#">Taichi Panda (太极熊猫)</a>, and <a href="#">Monster Hunter (怪物猎人大狩猎)</a></li></ul>

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**Company Description:**

Qihoo 360 Technology Co. Ltd. (“360”) offers comprehensive internet and mobile security products and services for free to about 523 million PC internet users and over 868 million mobile users in China. 360’s diverse services include cloud storage, web portals, e-commerce, web games, mobile games and other internet value-added services.

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**Address:**

Building No. 2, 6 Jiuxianqiao Road,  
Chaoyang District, Beijing 100015, People’s Republic of China

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<sup>226</sup> 360 was listed on NYSE (NYSE: QIHU), but went private on July 28, 2016.

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**YODO1, LTD**

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**Profile:**

Date of Incorporation: November 2011  
Founder: Henry Chi Hong Fong (方志航)  
Public/Private: Private Company  
Total Revenue: N/A  
Market Capitalization: N/A  
Website: <http://www.yodo1.cn/>  
Published Games: – Mobile Games: [Ski Safari \(滑雪大冒险\)](#), [Cut the Rope 2 \(割绳子 2\)](#), [Stampede \(疯狂动物园\)](#), and [Crossy Road \(天天过马路\)](#)

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**Company Description:**

Yodo1, Ltd (“[Yodo1](#)”), a company based in Beijing with studios in Shanghai, Nanjing, and Tokyo. Yodo1 works with game developers around the world to help their games succeed in China and everywhere else mobile games are played.

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**Address:**

Room 505, 5th Floor, Run Cheng Centre, 12 Dongdaqiao Avenue,  
Chaoyang District, Beijing 100020, People’s Republic of China

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**KUNLUN TECH CO., LTD****Profile:**

Date of Incorporation: 2011  
Founder: Zhou Yahui (周亚辉)  
Public/Private: SZ300418  
Total Revenue: RMB1.84 billion (equivalent of approximately US\$266.5 million<sup>227</sup> for the three quarters ended September 30, 2016)<sup>228</sup>  
Market Capitalization: RMB 24.53 billion (equivalent of approximately US\$3.55 billion<sup>229</sup> as of April 10, 2017)  
Website: <http://www.kunlun.com>  
Sample Published Games:

- PC Online Games: [Hope \(希望\)](#)
- Mobile Game: [Clash of Clans \(部落冲突\)](#), [Clash Royale \(部落冲突: 皇室战争\)](#), and [Boom Beach \(海岛奇兵\)](#)

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**Company Description:**

Kunlun Tech Co., Ltd. (“[Kunlun](#)”), a company based in Beijing with subsidiaries in Hong Kong, Taiwan, Japan, Korea, Malaysia, the United State of America and Europe. Kunlun develops and distributes PC online games and mobile games. Kunlun also operates an overseas mobile app stores “Brothersoft” and owns an internet browser “Opera”.

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**Address:**

Ming Yang International Centre B, XiZongBu Hutong 46,  
DongCheng District, Beijing 100005, People’s Republic of China

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<sup>227</sup> Based on RMB Exchange Rate.

<sup>228</sup> As of April 10, 2017, Kunlun has not released its 2016 Annual Report or Fourth Quarter 2016 Report.

<sup>229</sup> Based on RMB Exchange Rate.

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**KINGSOFT, INC**

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**Profile:**

Date of Incorporation:	1988
Founder:	Zhang Kaiqing (张铠卿)
Public/Private:	HKSE: 03888
Total Revenue:	RMB2.5 billion (equivalent of approximately US\$362.1 million <sup>230</sup> for year ended December 31, 2016)
Market Capitalization:	HKD26.5 billion (equivalent of approximately US\$3.41 billion <sup>231</sup> as of April 10, 2017)
Website:	<a href="http://www.kingsoft.com/">http://www.kingsoft.com/</a>
Sample Published Games:	<ul style="list-style-type: none"><li>- PC Online Games: <a href="#">JX Online 3 (剑网3)</a>, and <a href="#">Magic Hunting Legion (猎魔军团)</a></li><li>- Mobile Game: <a href="#">Swordsman World (剑侠世界)</a>, <a href="#">Brave Cross (全民神将)</a>, and <a href="#">Westward Journey Down the Magic (西游降魔)</a></li></ul>

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**Company Description:**

Kingsoft, Inc. (“[Kingsoft](#)”) is a leading software and internet services company listed on the Hong Kong stock exchange. Kingsoft has four subsidiaries including Season, Cheetah Mobile, Kingsoft Cloud and WPS. The Company has approximately 7,000 staff around the world. It has R&D centers and offices in Beijing, Zhuhai, Chengdu, Dalian, Guangzhou and Hong Kong and enjoys a large market share overseas in North America, Europe, Japan and Malaysia. Season, the subsidiary of Kingsoft, is a leading China online publisher focused on creating high quality games and game engines that push the boundaries of player experience in action entertainment. Season is also involved in small-medium sized investments for game studios worldwide.

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**Address:**

Kingsoft Tower, No. 33, Xiaoying West Road,  
Haidian District, Beijing 100005, People’s Republic of China

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<sup>230</sup> Based on RMB Exchange Rate.

<sup>231</sup> Based on HKD Exchange Rate.

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**37 INTERACTIVE ENTERTAINMENT (SHANGHAI) TECHNOLOGY CO., LTD.**

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**Profile:**

Date of Incorporation: 2011  
Founder: Li Yifei (李逸飞)  
Public/Private: SZ002555  
Total Revenue: RMB5.24 billion (equivalent of approximately US\$758.96 million<sup>232</sup> for three quarters ended September 30, 2016)  
Market Capitalization: RMB41.88 billion (equivalent of approximately US\$6.07 billion<sup>233</sup> as of April 10, 2017)  
Website: <http://www.37wan.net/>  
Sample Published Games: – Mobile Game: [Roman Empire \(罗马帝国\)](#), and [The Epoch of Eternity \(永恒世纪\)](#)

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**Company Description:**

37 Interactive Entertainment (Shanghai) Technology Co., Ltd. (“[37 Interactive](#)”) operates a top ten Chinese game platform specializing in publishing and operating mobile games and web games. 37 Interactive is also expanding their business to movie producing, animation making, online live streaming and VR technology development.

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**Address:**

Room 809, Yinxiang Road 655,  
Jading District, Shanghai 201802, People’s Republic of China

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<sup>232</sup> Based on RMB Exchange Rate.

<sup>233</sup> Based on RMB Exchange Rate.

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## YOUZU INTERACTIVE CO., LTD



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### Profile:

Date of Incorporation: 2008  
Founder: Lin Qi (林奇)  
Public/Private: SZ002174  
Total Revenue: RMB2.53 billion (equivalent of approximately US\$366.4 million<sup>234</sup> for year ended December 31, 2016)  
Market Capitalization: RMB24.27 billion (equivalent of approximately US\$3.52 billion<sup>235</sup> as of April 10, 2017)  
Website: <http://www.youzu.com/>  
Sample Published Games: – Mobile Game: [Junior Record of Three Kingdoms \(少年三国志\)](#) and [Wings of Fury \(狂暴之翼\)](#)

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### Company Description:

Youzu Interactive Co., Ltd. (“Youzu”) is a global entertainment company specializing in game development and distribution. Youzu operates in five main sectors: mobile games, browser games, distribution, platforms and overseas business. Youzu is committed to the highest game quality to publishing excellent games and movies worldwide, and to bringing Chinese and other Asian games to the western markets.

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### Address:

Building 2, Yi Shan Road 711,  
Xuhui District, Shanghai 200030, People’s Republic of China

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<sup>234</sup> Based on RMB Exchange Rate.

<sup>235</sup> Based on RMB Exchange Rate.

## MOBILE APP STORE PAGES

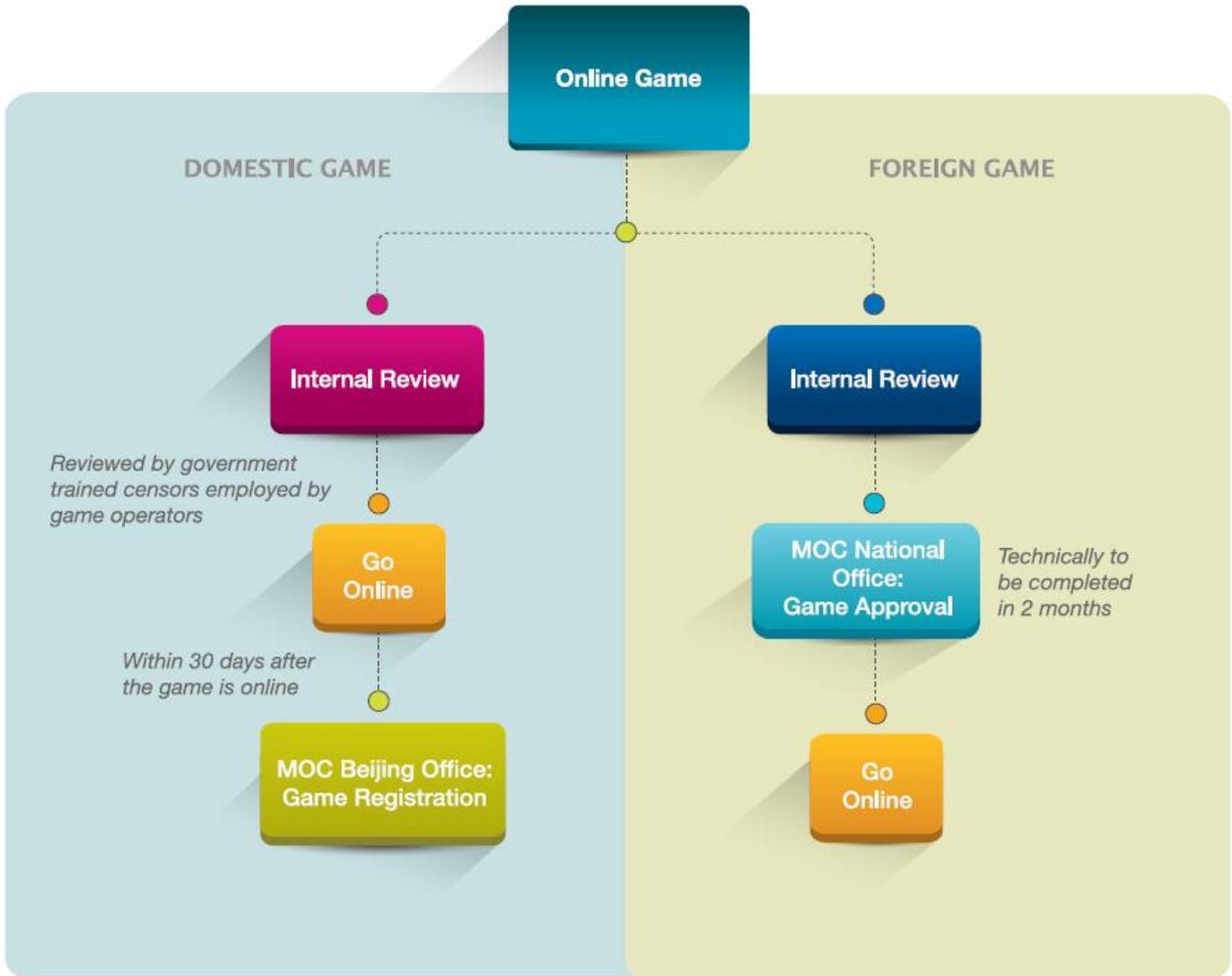
PRC Mobile App Stores	Profile
<p>MyApp (腾讯应用宝)</p> 	<p>Owner: Tencent Holdings Limited            Launch Date: December 2013            Website: <a href="http://sj.qq.com/">http://sj.qq.com/</a></p>
<p>360 Cellphone Assistant (360 手机助手)</p> 	<p>Owner: Qihoo 360 Technology Co. Ltd.            Launch Date: July 2011            Website: <a href="http://sj.360.cn/index.html">http://sj.360.cn/index.html</a></p>
<p>Baidu Cellphone Assistant (百度手机应用商店)</p> 	<p>Owner: Baidu, Inc.            Launch Date: March 2013            Website: <a href="http://shouji.baidu.com/">http://shouji.baidu.com/</a></p>
<p>Xiaomi App Store (小米应用商店)</p> 	<p>Owner: Beijing Xiaomi Technology Limited            (北京小米科技有限责任公司)            Launch Date: May 2012            Website: <a href="http://zhushou.xiaomi.com/">http://zhushou.xiaomi.com/</a></p>
<p>Wan Dou Jia (豌豆荚)</p> 	<p>Owner: Alibaba Group Holding Limited            (阿里巴巴集团公司)            Launch Date: December 2009            Website: <a href="https://www.wandoujia.com/">https://www.wandoujia.com/</a></p>
<p>Huawei App Store (华为应用商店)</p> 	<p>Owner: Huawei Technologies Co. Ltd.            (华为技术有限公司)            Launch Date: October 2010            Website: <a href="http://app.hicloud.com/">http://app.hicloud.com/</a></p>

PRC Mobile App Stores	Profile
<p>Hi Market (安卓网)</p> 	<p>Owner: Fujiang Baidu Internet and Technology Limited (福建百度博瑞网络科技有限公司)<sup>236</sup></p> <p>Launch Date: September 2010</p> <p>Website: <a href="http://www.hiapk.com/">http://www.hiapk.com/</a></p>
<p>Vivo Cellphone Assistant (Vivo 手机助手)</p> 	<p>Owner: Vivo Mobile Communication Limited (维沃移动通信有限公司)</p> <p>Launch Date: N/A</p> <p>Website: <a href="http://zs.vivo.com.cn/">http://zs.vivo.com.cn/</a></p>
<p>Oppo App Store</p> 	<p>Owner: Oppo Electronics Corp. (广东欧珀移动通信有限公司)</p> <p>Launch Date: N/A</p> <p>Website: <a href="http://store.oppomobile.com/">http://store.oppomobile.com/</a></p>
<p>China Mobile Mobile Market (中国移动移动商城)</p> 	<p>Owner: China Mobile Limited (中国移动通信集团公司)</p> <p>Launch Date: N/A</p> <p>Website: <a href="http://mm.10086.cn/">http://mm.10086.cn/</a></p>
<p>China Telecom Yi Store (中国电信易商店)</p> 	<p>Owner: China Telecommunications Corporation (中国电信集团)</p> <p>Launch Date: N/A</p> <p>Website: <a href="https://www.189store.com">https://www.189store.com</a></p>
<p>China Unicom Wo Store (中国联通沃商店)</p> 	<p>Owner: China Unicom Global Limited (中国联通集团公司)</p> <p>Launch Date: N/A</p> <p>Website: <a href="http://store.wo.com.cn/">http://store.wo.com.cn/</a></p>

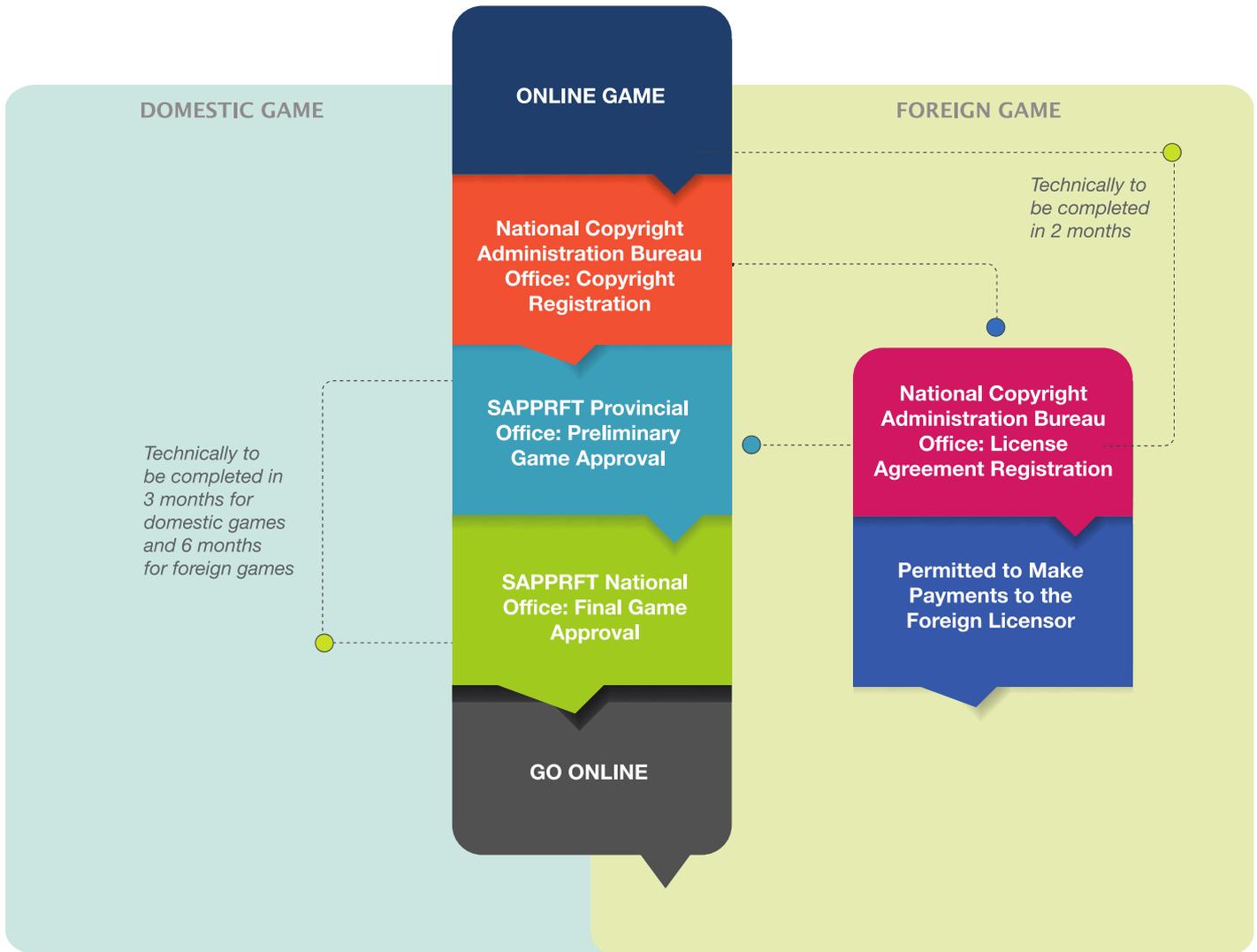
<sup>236</sup> Fujiang Baidu Internet and Technology Limited (福建百度博瑞网络科技有限公司) is an affiliate of Baidu, Inc.

REGULATORY PROCEDURE FOR LAUNCHING A GAME IN CHINA

MOC GAME APPROVAL PROCESS



## SAPPRFT GENERAL GAME APPROVAL PROCESS



## SAPPRFT APPROVAL PROCESS FOR SIMPLE DOMESTIC MOBILE GAMES<sup>237</sup>



<sup>237</sup> See Article 3 of Mobile Game Approval Notice, issued by SAPPRFT on May 24, 2016.

## GAME APPROVAL AND REGISTRATION SUBMISSION MATERIALS

MOC Foreign Game Approval <sup>238</sup>	MOC Domestic Game Registration <sup>239</sup>
<ul style="list-style-type: none"> <li>- Game approval application form for foreign game;</li> <li>- Subject and content instruction descriptions;</li> <li>- Operation manual of the game (both Chinese and foreign language versions);</li> <li>- Game samples:               <ul style="list-style-type: none"> <li>• Client-based game: three client software CD-ROM or DVD with three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> <li>• Web game: game server IP address, and three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> <li>• Mobile game: three mobile phones with the game installed or simulator IP address which can be used through a computer to play the game, and three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> <li>• Other game: three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> </ul> </li> <li>- All dialogues, descriptive texts and lyrics within the game (both Chinese and foreign language versions) (electronic version only);</li> <li>- Game license agreements (both Chinese and foreign language versions), original versions or photocopies of the copyright certificate and copyright authorization certificate;</li> <li>- Rating information and related certificates;</li> </ul>	<ul style="list-style-type: none"> <li>- Game registration application form;</li> <li>- Subject and content instruction descriptions;</li> <li>- Operation manual of the game;</li> <li>- Game samples:               <ul style="list-style-type: none"> <li>• Client-based game: three client software CD-ROM or DVD with three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> <li>• Web game: game server IP address, and three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> <li>• Mobile game: three mobile phones with the game installed or simulator IP address which can be used through a computer to play the game, and three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> <li>• Other game: three (3) game accounts and passwords which allow users to see all scenarios and use all game functions;</li> </ul> </li> <li>- All dialogues, descriptive texts and lyrics within the game (electronic version only);</li> <li>- Photocopies of the internet culture license and business license of the operator;</li> <li>- Self-review report (indicating whether the game contains any illegal content or any controversial content that may violate the content restrictions);</li> </ul>

<sup>238</sup> See the Application Instruction of Imported Game at MOC website:  
<http://www.ccm.gov.cn/swordcms/publish/default/static/bsguide/xzxk/wlyycpnrc/jkwlyybs/index.htm>.

<sup>239</sup> See the Registration Instruction of Domestic Game at MOC website:  
[http://www.gov.cn/fwxx/bw/whb/content\\_2264156.htm](http://www.gov.cn/fwxx/bw/whb/content_2264156.htm).

MOC Foreign Game Approval <sup>238</sup>	MOC Domestic Game Registration <sup>239</sup>
<ul style="list-style-type: none"> <li>- Photocopies of the internet culture license and business license of the operator;</li> <li>- Self-review report (indicating whether it contains any illegal content or any controversial content that may violate the content restrictions); and</li> <li>- Any other documents that the MOC may require.</li> </ul>	<ul style="list-style-type: none"> <li>- Photocopies of the software copyright registration certificate (license or related agreement to explain the authorization if the game is not self-developed); and</li> <li>- If the game is co-operated by several operators, then the photocopies of the co-operating agreement executed by all operators, the internet culture license, business license of each operator, and the co-operating registration form shall be submitted.</li> </ul>

**STATE ADMINISTRATION OF PRESS, PUBLICATION, RADIO, FILM AND  
TELEVISION GAME APPROVAL APPLICATION DOCUMENTS**

SAPPRFT Foreign Game Approval <sup>240</sup>	SAPPRFT Domestic Game Approval <sup>241</sup>
<p><b>Qualification</b></p> <ul style="list-style-type: none"> <li>- The applicant must hold an online publishing service license (网络出版服务许可证) issued by SAPPRFT;</li> <li>- Foreign game copyright license agreement must be registered with the National Copyright Bureau;</li> <li>- Operator must hold a value-added telecommunication license;</li> <li>- Operator must hold a Game Anti-Fatigue System and Real-Name Registration Certification.</li> </ul>	<p><b>Qualification</b></p> <ul style="list-style-type: none"> <li>- The applicant must hold an online publishing service license (网络出版服务许可证) issued by SAPPRFT;</li> <li>- Domestic game must be registered with the National Copyright Bureau (the source code of a domestic game must be submitted);</li> <li>- Original owner of the domestic game must be a PRC citizen or a domestic company;</li> <li>- Operator must hold a value-added telecommunication license;</li> <li>- Operator must hold a Game Anti-Fatigue System and Real-Name Registration Certification.</li> </ul>
<p><b>Documents</b></p> <ul style="list-style-type: none"> <li>- Consent of provincial department of SAPPRFT;</li> <li>- Foreign game publishing application form (including introductions of publisher, game to be published and operator);</li> <li>- Copyright license agreement registration with the National Copyright Bureau;</li> <li>- Operators' business license and value-added telecommunication license;</li> <li>- Detailed introduction of the game content;</li> <li>- Game review opinion of the publisher;</li> <li>- Details of the anti-addiction system;</li> <li>- Three game accounts for administrators who will review the game and three test accounts for the game anti-fatigue system;</li> <li>- Text within the game (Chinese) and the lexicon for blocked words;</li> <li>- For client based games: three disks for the installation of the game client, for web games: the login website, and for mobile games: the game download website, three disks for the installation of the mobile game or three devices which have installed the mobile game.</li> </ul>	<p><b>Documents</b></p> <ul style="list-style-type: none"> <li>- Consent of provincial department of SAPPRFT;</li> <li>- Game review opinion of the publisher;</li> <li>- Copyright Certificate and Business License of owner of copyright;</li> <li>- Operators' business license and value-added telecommunication license;</li> <li>- Colorful screenshots of the game with explanations;</li> <li>- Text within the game (Chinese) and the lexicon for blocked words;</li> <li>- Details of the anti-addiction system;</li> <li>- Three game accounts for administrators who will review the game and three test accounts for the game anti-fatigue system;</li> <li>- For client based games: two disks for the installation of the game client, for web games: the login website, for mobile games: two (2) mobile phones which have installed the mobile game; for console games: two (2) special device installed with game;</li> <li>- Two (2) disks with all application documents and game demo video.</li> </ul>

<sup>240</sup> See the Application Instruction of Foreign Game Publishing at SAPPRFT website:  
<http://www.gapp.gov.cn/govservice/1966/114217.shtml>.

<sup>241</sup> See the Application Instruction of Domestic Game Publishing at SAPPRFT website:  
<http://www.gapp.gov.cn/govservice/1966/271413.shtml>.

## GAME CONTENT RESTRICTIONS

As mentioned in Section 5.1 (Game Content and Functionality Restrictions), the tables in this Annex V-A include translations of the content restriction standards set forth in (i) the Specification of Mobile Game Content (2016 Edition) (移动游戏内容规范 (2016年版)) issued by the China Audio-Video and Digital Publishing Association (中国音像与数字出版协会), an organization that is affiliated with SAPPRFT, and (ii) MOC's internal content censorship training materials. Some of these tables are followed by examples, which may provide additional insight into the actual application of these general standards.

### 1. Opposes the fundamental principles determined in the constitution;

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- opposes the people's democratic dictatorship or disparages the People's Congress system, electoral system, justice system, regional autonomy and special administration region system, military system, multi-party cooperation and political consultation system, basic economy system and socialist system;</li> <li>- opposes the leadership of the Communist Party of China;</li> <li>- opposes the guidance of Marxism-Leninism, Mao Zedong Thought and the theoretical system of socialism with Chinese characteristics.</li> </ul>	<ul style="list-style-type: none"> <li>- attacks the system of socialism with Chinese characteristics;</li> <li>- opposes the leadership of the Communist Party of China.</li> </ul>

### 2. Endangers the unity, sovereignty or territorial integrity of the nation;

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- Interferes with or attacks China's sovereignty of politics, economics, culture, military, legalization, justice, administration and diplomacy;</li> <li>- secedes Taiwan, Hong Kong, Macau, Xinjiang, Tibet, Diaoyu Islands, Red Islands or South Sea Islands from China;</li> <li>- treats Taiwan, Hong Kong or Macau as a sovereign state;</li> <li>- omits quotation marks when referring to Taiwan's current government</li> </ul>	<ul style="list-style-type: none"> <li>- Interferes with or attacks China's sovereignty of politics, economics, culture, military, legalization, justice, administration and diplomacy;</li> <li>- secedes Taiwan, Hong Kong, Macau, Xinjiang or Tibet from China;</li> <li>- embodies "Taiwan independence", "Tibet independence", "Xinjiang independence" or "East Turkestan";</li> <li>- maliciously marks China's map.</li> </ul>

SAPPRFT Standard	MOC Standard
<p>institution, for example, “President” and “Executive Yuan”;</p> <ul style="list-style-type: none"> <li>- posts the marks of Taiwan current government institution;</li> <li>- broadcasts aggression; distorts historical facts and plays the role of aggressor; creates a scenario where a foreign military invades China’s territory, or where a foreign military attacks China’s territory or Chinese consulates in the name of anti-terrorism or hunting for criminals;</li> <li>- describes foreign vessels or airplanes entering into China’s territory or airspace, exclusive economic zone, continental shelf or subsoil tunneling into China;</li> <li>- misinterprets China’s territory, exclusive economic zone, continental shelf, subsoil and other disputed boundaries and zones;</li> <li>- posts as China’s map a map that does not follow: the boundaries reflected in treaties signed by China and other countries; maps officially released by China regarding disputed boundaries; Chinese historical maps.</li> </ul>	

Example 1: SAPPRFT has required games to not include the name of a real country, especially in the context of World War II games. In the game King of Warship (巅峰战舰) (“KOW”), for example, the name of “Japanese troops” and “USA troops” in the original version were both revised before the game’s commercial launch. One of the reasons for such revisions was to avoid distorting historical reality because players of KOW who control battleship of the “Japanese troops” are able to ally with and fight alongside players who control battleship of “USA troops”.<sup>242</sup>

Example 2: The storyline and background of a game shall not take place in any areas of mainland China, Hong Kong, Macau or Taiwan.<sup>243</sup>

<sup>242</sup> See “[Same Game Censorship. Why my Games were Rejected While Others’ Games were Approved?](#)” (都是游戏审批，凭啥人家过了我就被打回?) (Chinese), posted at api.weixin.soften.cn on May 31, 2016.

<sup>243</sup> See “[Navigating the Regulatory Landscape in China’s US\\$25 Billion Gaming Market](#)” (English), posted at Gamasutra on February 17, 2017.

**3. Divulges state secrets, endangers national security, or damages the dignity or interests of the nation;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- includes state confidential information regarding: important decision made by the Communist Party of China or the PRC government; confidential maps; national defense construction; diplomatic activities; state economic and social development, or science and technology; national security and criminal activities investigation;</li> <li>- propagandizes secessionist forces, anti-China organizations and spy agencies;</li> <li>- socializes or encourages any organization or individual to overthrow the PRC government, secede territory from China or undermine China’s national security;</li> <li>- attacks, distorts, incinerates, impairs, tarnishes or damages China’s national flag, national anthem, national emblem, the Communist Party of China flag, the Communist Party of China emblem, ministry flag, ministry emblem, Tian’an men, Great Hall of the People, Great Wall or Cloud Pillar;</li> <li>- distorts and impairs prominent figures of China;</li> <li>- violates China’s diplomatic policies or distorts the image of leaders or the military of other countries;</li> <li>- propagates Fascism, prettifies the aggression and images of war criminals or permits end users to play the role of war criminals.</li> </ul>	<ul style="list-style-type: none"> <li>- includes state confidential information;</li> <li>- propagandizes secessionist forces, anti-China organizations and spy agencies;</li> <li>- includes colonialism and racialism information;</li> <li>- attacks, distorts, incinerates, impairs, tarnishes and damages China’s national flag, national anthem, national emblem, Communist Party of China flag;</li> <li>- distorts historical events, PRC culture and history.</li> </ul>

Example 3: Similar to KOW, no real country name is used in the game World of Warships (战舰世界). The “Soviet Union troops”, the “USA troops” and the “German troops” in the non-China version of World of Warships were revised to “S team”, “M team” and “D team”, respectively, in the China version of the game. Using real country names, in addition to possibly causing a distortion of history (as described above), would

allow game players to play or control the soldiers of axis powers during World War II, which can be regarded as propagating Fascism.<sup>244</sup>

**4. Incites ethnic hatred or racial discrimination or undermines national solidarity, or infringes upon national customs and habits;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- reinforces contradictions of ethnic groups;</li> <li>- distorts the images of all ethnic groups;</li> <li>- belittles or denies the history or contribution of ethnic groups;</li> <li>- propagates that one ethnic group is in a dominant position with privileges;</li> <li>- destroys ethnic unity, religious harmony and freedom of religious belief;</li> <li>- distorts or damages traditional custom, taboo and symbols of ethnic groups;</li> <li>- propagates foreign denominations to damage ethnic unity and interfere with religious affairs.</li> </ul>	<ul style="list-style-type: none"> <li>- reinforces contradictions of ethnic groups;</li> <li>- insults the unique traditions and religious faith of minorities;</li> <li>- embodies historic events that damage ethnic unity;</li> <li>- distorts the images of ethnic groups;</li> <li>- distorts landmarks or symbolic images of China’s civilization or traditional culture.</li> </ul>

**5. Propagates evil cults or superstition;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- propagates heresy, including Falun Gong;</li> <li>- propagates hierarchical worship;</li> <li>- propagates heresy cannon, doctrine, books or marks;</li> <li>- propagates participation in heretical activities;</li> <li>- broadcasts heresy and controls others mentally;</li> <li>- distorts or tampers with traditional religious doctrines;</li> <li>- functionally enables end users to avoid evils or receive superstitious fortune telling;</li> <li>- creates or exaggerates hyperphysical or supernatural phenomenon.</li> </ul>	<ul style="list-style-type: none"> <li>- distorts religious policies of the government of China, twists legal religious faiths, and insults believers of legal religion;</li> <li>- propagates heresy organizations, cannon or doctrine;</li> <li>- propagates religious extremism;</li> <li>- broadcasts superstitious ideas.</li> </ul>

<sup>244</sup> See “[Same Game Censorship, Why my Games were Rejected While Others’ Games were Approved?](#)” (都是游戏审批, 凭啥人家过了我就被打回?) (Chinese), posted at [api.weixin.qq.com](http://api.weixin.qq.com) on May 31, 2016.

**6. Disseminates rumors, disrupts social order or undermines social stability;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- has functions or storylines that propagate activities impairing social stability;</li> <li>- propagates activities that obstruct government officers in performing their duties;</li> <li>- uglifies or attacks people or ethnic groups within certain areas;</li> <li>- seduces end users to pay legal currency directly or indirectly in exchange for game items or services by random drawings and without posting detailed rules.</li> </ul>	None.

Example 4: A main character’s background story in a game shall not be that of an “assassin”, and SAPPRFT suggests modifying the identity of such characters to be law enforcement officers or military personnel. A game’s mission objective narratives should be changed to exclude words such as “assassinate” and “kill”. Graphic depictions, like blood and headshot animations, must be modified.<sup>245</sup>

**7. Propagates obscenity, pornography, gambling, violence or instigates crimes;**

**(1) Propagates obscenity or pornography**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- includes content of incest, rape, rape by turns or has such functions;</li> <li>- includes content of sexual behavior of minors or has such functions;</li> <li>- includes detailed content of homosexual sex or has such functions;</li> <li>- includes detailed content of parasexuality or has such functions;</li> <li>- includes detailed content of prostitution or has such functions;</li> <li>- includes detailed content of the naked human body or reproductive organs;</li> <li>- includes detailed content of reproductive</li> </ul>	<ul style="list-style-type: none"> <li>- describes sexual seduction, sexual harassment or sexual insults;</li> <li>- includes detailed content of the naked human body or reproductive organs;</li> <li>- includes content of incest, rape, rape by turns or has such functions.</li> </ul>

<sup>245</sup> See “[Navigating the Regulatory Landscape in China’s US\\$25 Billion Gaming Market](#)” (English), posted at Gamasutra on February 17, 2017.

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>organs of animals;</li> <li>- includes detailed content of sex products and their functions;</li> <li>- embodies or implies sexual activities;</li> <li>- includes detailed content of sex techniques;</li> <li>- embodies sexually transmitted diseases, including syphilis or AIDS;</li> <li>- describes the sex trade, sex psychology, sex activities or sex experiences in bodily language;</li> <li>- publicizes sexual liberation and sexual freedom.</li> </ul>	

**(2) Propagates gambling;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- introduces detailed information of gambling and the function of gambling items;</li> <li>- has the function of gambling or provides gambling services;</li> <li>- charges a per match fee based on whether or not a player wins or loses the match, either in legal currency or virtual currency;</li> <li>- includes a mini-game of chance with virtual currency betting where there is no upper bet or daily loss limit;</li> <li>- has the function of using earned credits or virtual currencies in exchange for cash or items;</li> <li>- provides services of transferring earned credits between players;</li> </ul>	<ul style="list-style-type: none"> <li>- has the function of gambling, or advertises gambling.</li> </ul>

Example 5: To assess whether a game contains gambling features, see the standards detailed in Section 5.1 (Game Content and Functionality Restrictions).

**(3) Propagates violence;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- life-like performance or description of an incomplete human body or human body dismemberment, performs detailed process of injury or performs scenes of blood spewing or a river of</li> </ul>	<ul style="list-style-type: none"> <li>- prettifies violence or performs violence with reckless abandon;</li> <li>- deliberately shows scenes of blood spewing, cruelty, terror or drug taking, which might induce teenagers to</li> </ul>

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>blood flow;</li> <li>- deliberately shows dead bodies, dismembered bodies, corpses or includes other acts contrary to common sense;</li> <li>- advocates the effects of weapons of mass destruction, chemical, biological or nuclear weapons, or deliberately rendering horrible scenes of mass destruction;</li> <li>- deliberately designs characters, images or scenes that are too horrible.</li> </ul>	<ul style="list-style-type: none"> <li>imitate;</li> <li>- prettifies images of criminals, which might induce teenagers to feel sympathy with criminals;</li> <li>- deliberately shows the details of criminal offences, to induce teenagers to imitate;</li> <li>- prettifies crimes against humanity or society, including slaughter, genocide or other inhumane activities.</li> </ul>

Example 6: In 2009, in connection with the transition of World of Warcraft from one domestic operator to another and a new round of censorship review, piles of bones were replaced with bags of sand, the color of blood was changed from red to black and multi-headed icons were replaced with boxes.<sup>246</sup>

During a 2009 interview, Song Jianxin (宋建新), the current deputy director of the Digital Publishing Division (数字出司) of SAPPRFT, which is the SAPPRFT department in charge of game censorship, indicated that the depiction of bodily dismemberment, including the severing of heads, arms or legs, is not permitted in games.<sup>247</sup>

Example 7: Some reporters have indicated that content censorship requirements also apply to the logo of a mobile game. If the color of the logo is red, for example, the game might not be approved by SAPPRFT because the logo is suggestive of “blood” or “violence”.<sup>248</sup>

#### **(4) Propagates or instigates crimes;**

Example 8: In July 2009, MOC issued a circular banning mafia style games, which included games on China’s domestic social networking sites that resemble the game Mafia Wars on Facebook.<sup>249</sup>

Example 9: In April 2011, MOC issued a notice requiring websites and internet cafés inside China to remove all content relating to 39 specific video games, most of which were pirated versions of foreign single player PC games that were not approved for

<sup>246</sup> See “[China Censors World of Warcraft: Blood to Oil](#)”, posted at Tom's Hardware on August 7, 2009.

<sup>247</sup> See “[GAPP Issued Violence Standards. What Changes Should WoW Make](#)” (版署出台管理暴力标准魔兽哪些需整改) (Chinese), posted at people.com.cn on August 25, 2009.

<sup>248</sup> See “[About Game Approval, Half a Year Passed, You Might Still Do Not know the Challenges](#)” (再说版号，半年之后，你可能还不知道的审批的那些坑) (Chinese), posted at api.weixin.soften.cn on November 23, 2016.

<sup>249</sup> See “[Mafia-Themed Online Games Banned](#)”, posted at Xinhuanet.com on July 29, 2009.

commercial release in China, including Call of Duty and Grand Theft Auto, because such games propagate crime in violation of content restrictions.<sup>250</sup>

**8. Insults or slanders others, or otherwise infringes upon the legitimate rights of others;**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- includes language, gesture or movement that insult or slander others;</li> <li>- maliciously uses euphemisms of politicians or public figures;</li> <li>- deliberately performs physiological or mental defect of others to infringe on the personal dignity of others;</li> <li>- broadcasts false facts to infringe on the reputation of others;</li> <li>- illegally uses the portraits of others to infringe on their images;</li> <li>- exposes the privacy of others and infringes on the private lives of others.</li> </ul>	<ul style="list-style-type: none"> <li>- insults or slanders others;</li> <li>- infringes on the privacy of others or their personal freedom;</li> <li>- abuses others, or curses upon others;</li> </ul>

**9. Endangers social morality or national splendid cultural traditions; or**

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- violates basic moral requirements;</li> <li>- deliberately performs filthy fights or dirty talk;</li> <li>- damages or destroys historical relics, places of interests, government offices or landmark building;</li> <li>- performs discrimination against women, children, the elderly or disabled people;</li> <li>- includes storylines which are harmful for a harmonious society;</li> </ul>	<ul style="list-style-type: none"> <li>- violates basic moral requirements;</li> <li>- broadcasts negative lifestyles;</li> <li>- publicizes negative attitudes toward love and marriage;</li> <li>- includes language or images that are disgusting to the public;</li> <li>- publicizes the destruction of the environment and animal cruelty.</li> </ul>

<sup>250</sup> See “[China to Ban 39 Games over Violent, Pornographic Content](#)”, posted at whatsonningbo.com on April 20, 2011, and “[39 Games Including Call of Duty, Grand Theft Auto were Banned](#)” (使命召唤、侠盗猎车手等 39 款游戏遭封杀) (Chinese), posted at ccidnet.com on April 20, 2011. The 39 games consist of: (1) Call of Duty 2; (2) Call of Duty 4: Modern Warfare; (3) Call of Duty 5: World at War; (4) Call of Duty: Modern Warfare 2; (5) ShellShock: Nam’67; (6) ShellShock 2: Blood Trails; (7) Grand Theft Auto; (8) Grand Theft Auto: London 1969; (9) Grand Theft Auto 2; (10) Grand Theft Auto 3; (11) Grand Theft Auto: Advance; (12) Grand Theft Auto: Vice City; (13) Grand Theft Auto: San Andreas; (14) Grand Theft Auto: Liberty City Stories; (15) Grand Theft Auto: Vice City Stories; (16) Grand Theft Auto 4; (17) Grand Theft Auto: Chinatown Wars; (18) Grand Theft Auto: The Lost and Damned; (19) Grand Theft Auto: The Ballad of Gay Tony; (20) Kane and Lynch: Dead Men; (21) Kane and Lynch 2: Dog Days; (22) Mafia; (23) Mafia 2; (24) Total Overdose; (25) Saints Row; (26) Saints Row 2; (27) True Crime: New York City; (28) True Crime: Streets of L.A.; (29) Mercenaries; (30) Mercenaries 2 World in Flames; (31) 50Cent: Bulletproof; (32) 50 Cent: Blood on the Sand; (33) The Godfather; (34) The Godfather II; (35) Scarface: The World is Yours; (36) Crackdown; (37) Forbidden Siren; (38) Forbidden Siren 2; and (39) Siren New Translation.

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- broadcasts lifestyles like “Money is King”, “break up the pale”, “wife swap”, “extramarital affair” or “One night stand”;</li> <li>- advocates abuse for personal gain or dealing power for money;</li> <li>- undermines national cultural heritage, or twists history, events or representations;</li> <li>- advocates a patriarchal clan system, “man is superior to woman” or polygamous marriage;</li> <li>- attacks the creditability of China’s traditional cultures;</li> <li>- denies China’s national spirit.</li> </ul>	

Example 10: In September 2009, the company behind a webgame entitled “Hot Blood Three Kingdom” (热血三国) was punished by SAPPRFT for using inappropriate promotional slogans such as “rob people, rob money, and rob the whole world” in the game.<sup>251</sup>

Example 11: In December 2009, MOC required Five Minutes, the developer of a Chinese version of the social networking game Happy Farm, to replace the in-game term “tou cai”(偷菜), which means “stealing vegetables”, with the term “shou huo”(收获), which means “harvesting”,<sup>252</sup> apparently in reaction to the anti-social nature of stealing vegetables from a friend’s farm.

Example 12: One game developer has indicated that SAPPRFT refused an application of a game that included an in-game virtual item called a “tiger skin” because “tiger skin” is suggestive of hunting and killing tigers, which are first-grade state protected animals.<sup>253</sup>

**10. Is otherwise prohibited by the laws, or administrative regulations of the PRC.**

SAPPRFT Standard	MOC Standard
Endangers teenagers’ physical and psychological health:	None.

<sup>251</sup> See “[GAPP Punished Several Vulgar Online Games](#)” (新闻出版总署查处一批低俗网游) (Chinese), posted at GAPP.gov.cn on September 29, 2009.

<sup>252</sup> See “[China Prohibits Vegetable ‘Stealing’ in Social Games](#)”, posted at Marbridgeconsulting.com on December 17, 2009.

<sup>253</sup> See “[You Need to Notice the Issues in the Game Approval Application](#)” (手机游戏版号审批过程中，除了不能出现英文之外还有那些奇葩事需要注意) (Chinese), posted at 41 fun.com on July 7, 2016.

SAPPRFT Standard	MOC Standard
<ul style="list-style-type: none"> <li>- advocates criminal offenses to induce teenagers to imitate; concretely describes criminal offenses to encourage or induce teenagers to imitate; prettifies images of criminals; advocates activities that infringe on the property right of third parties, such as playing the role of robbers, stealing or robbery; describes escape from legal punishment, and has the function of bribery or jail escape; describes mafia organizations; advocates and induces malicious player killing (PK);</li> <li>- advocates drug taking and drug trafficking to induce teenagers to imitate; concretely describes planting poppy or other drug plants; advocates or concretely describes drug production, trafficking or purchase; advocates or concretely describes drug taking, or inducing or forcing others to take drugs; advocates or concretely describes the function of drugs; advocates or concretely describes making profits from drug trafficking;</li> <li>- advocates other activities endangering teenagers' physical or psychological health; describes vulgar lifestyles; concretely describes teenagers' drinking or smoking; concretely describes teenagers' entering into places that are not suitable for teenagers; encourages teenagers to live together and marry.</li> </ul>	

Example 13: The government does not encourage including game features related to PK, PVP or revenge, as such game features might easily be deemed “including malicious player killing”. To avoid this, the game “The Legend of Mir 2” (传奇) utilizes a color changing scheme whereby players that kill other players are turned yellow and then later red. The red-label indicates to other players that the labeled player has recently killed another player, and the red-labeled player often becomes the target of other players in the game. Red-labeled players are also prohibited from entering into certain places in the game.<sup>254</sup>

<sup>254</sup> See “[Same Game Censorship, Why my Games were Rejected While Others' Games were Approved?](#)” (都是游戏审批, 凭啥人家过了我就被打回?) (Chinese), posted at [api.weixin.qq.com](http://api.weixin.qq.com) on May 31, 2016.

Example 14: Words about “revenge” shall not appear in games. In the game “Boom Beach” (海岛奇兵), players are able to view videos that show how other players attacked their base, and the game encourages such activities. Although “Boom Beach” has obtained both MOC and SAPPRFT approval, which suggests that the relevant authorities are allowing games with such features, the word “revenge” is not allowed to appear in the game.<sup>255</sup>

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<sup>255</sup> See “[Same Game Censorship, Why my Games were Rejected While Others’ Games were Approved?](#)” (都是游戏审批, 凭啥人家过了我就被打回? ) (Chinese), posted at [api.weixin.qq.com](http://api.weixin.qq.com) on May 31, 2016.

## GAME FUNCTIONALITY RESTRICTIONS

As mentioned in the Section 5.1 (Game Content and Functionality Restrictions), the bulletin in this Annex V-B is the translation of the list of game functionality restrictions included in the MOC's internal content censorship training materials.

1. Marriage Functionality
  - Shall not be available for teenagers.
2. Children Raising Functionality
  - Must be designed for fostering a sense of responsibility of players and developing the ability of players to educate children; and
  - Must avoid inducing players to be online for a long time.
3. Pet Raising Functionality
  - Must avoid inducing players to be online for a long time; and
  - Shall not include any content providing for the mistreatment of animals.
4. Combat Functionality
  - A player shall not be able to initiate a player killing (PK) without the other players' consent;
  - Shall not induce players having desires of revenge;
  - Shall not include scenes of blood, terror or disabled body; and
  - Shall not encourage malicious player killing (PK).
5. Tasks and Requests Functionality
  - Shall not have storylines that maliciously distort historic events or damage historic images; and
  - Shall have the function that enables players to suspend game playing and save game files, and shall not force players to be online for a long time.
6. Union Functionality
  - Shall ensure that players can freely participate in and quit unions, and shall not infringe on a players willingness to participate.
7. Entertainment Functionality
  - Online games shall not have functions that allocate items randomly to induce players to transfer legal currency or virtual currency for game services;
  - Online games shall not have gambling features, such as any contents of fried golden flower (炸金花), five card stud, baccarat, blackjack or handbookinger;
  - Online game must have upper limits for (i) the amount a player can bet in each

- match, and (ii) the amount that a player can lose per day;<sup>256</sup>
- Online games shall not provide services that enable players to transfer game credits for cash, or transfer game credits between players.

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<sup>256</sup> As discussed in Section 5.1 (Game Content and Functionality Restrictions), a maximum bet limit from RMB20 to RMB80 of purchased virtual currency is common and the maximum amount a player can lose in one day shall not exceed RMB500 of purchased virtual currency.

## COMPLIANCE SCORECARD

As discussed in Section 2 (Scope of China’s Game Market) above, the China game market is dominated by online games, and it is possible to check compliance with various regulations by visiting the websites and mobile apps of leading game operators, mobile app stores and developers. Although the digital game industry is heavily regulated by PRC regulators, not all of the regulations are fully implemented or enforced. This regulation compliance scorecard provides a snapshot view of which rules are being enforced, and which ones are being ignored.

1. Game Compliance Scorecard. The table below summarizes compliance with the rules regarding game approvals and real-name registration by the top fifty (50) PC online games and top fifty (50) mobile games.

### (1) PC Online Game Compliance Check

Game Type	MOC Game Approval <sup>257</sup>	SAPPRFT Game Approval <sup>258</sup>	Publishing Agent <sup>259</sup>	Real-name Registration <sup>260</sup>
PC Online Games <sup>261</sup>	42/50	38/50	9/38	20/50
<b>Compliance Rate:</b>	<b>84%</b>	<b>76%</b>	<b>24%</b>	<b>40%</b>

<sup>257</sup> Data regarding compliance with MOC game approval requirements is based on (i) the self-posted MOC game approval numbers on the websites of various online game operators, and (ii) the list of MOC approved games at the following MOC website: <http://www.ccm.gov.cn/swordcms/publish/default/static/main/index.htm>.

<sup>258</sup> Data regarding compliance with SAPPRFT game approval requirements is based on (i) the self-posted SAPPRFT game approval numbers on the websites of various online game operators, and (ii) the list of SAPPRFT approved games at the following SAPPRFT website: <http://www.gapp.gov.cn/govservice/1980.shtml>.

<sup>259</sup> Domestic operators of PC online games that do not have online publishing service licenses are generally able to cooperate with stated-owned publishing houses that do such licenses in order to apply for SAPPRFT game approval. Such stated-owned publishing houses are referred herein as “publishing agents”. We regard a game to be using a publishing agent when (i) the game “operation entity” (运营单位) and the game “publishing entity” (出版单位) are two different entities, and (ii) such entities are not affiliates.

<sup>260</sup> We regard a game to be compliant with real-name registration rules when, in connection with registration, such game requires its players to provide their (i) mobile phone numbers, and such mobile phone numbers are verified by text message; or (ii) names and national identification numbers. If a game’s registration process can be completed by providing a fake identification number with a random name, then we regard this game as not complying with the real-name registration rules.

<sup>261</sup> The list of the top fifty PC client-based games is based on the voting of users on 17173.com on March 1, 2017. See “[17173 Online Game Ranking List](#)” (17173 网络游戏排行榜) (Chinese).

(2) Mobile Game Compliance Check

Game Type	MOC Game Approval <sup>262</sup>	SAPPRFT Game Approval <sup>263</sup>	Publishing Agent <sup>264</sup>	iOS Real-name Registration <sup>265</sup>	Android Real-name Registration <sup>266</sup>
Mobile Games <sup>267</sup>	43/50	36/50	8/36	0/50	14/50
<b>Compliance Rate:</b>	<b>86%</b>	<b>72%</b>	<b>22.22%</b>	<b>0.00%</b>	<b>28%</b>

2. Operation Compliance Scorecard. The table below summarizes compliance with the online game operator license requirements by online game operators in China.

Game Operator	Value-Added Telecommunication License <sup>268</sup>	Internet Culture License <sup>269</sup>	Online Publishing Service License <sup>270</sup>
Tencent (腾讯)	Yes	Yes	Yes
NetEase (网易)	Yes	Yes	Yes
Perfect World (完美世界)	Yes	Yes	Yes
Changyou (畅游)	Yes	Yes	Yes
KongZhong (空中)	Yes	Yes	Yes

<sup>262</sup> Data regarding compliance with MOC game approval requirements for mobile games is based on the same test as the test for PC online games.

<sup>263</sup> Data regarding compliance with SAPPRFT game approval requirements for mobile games is based on the same test as the test for PC online games.

<sup>264</sup> Whether a mobile game uses a publishing agent is based on the same test as the test for PC online games.

<sup>265</sup> Each iOS version of the mobile game that we tested is downloadable through China’s Apple App Store. We regard a mobile game as compliant with real-name registration rules: (i) a “tourist model”, which allows players to play the mobile game without submitting any player identification information or mobile phone number, does not exist, and (ii) the game requires players to either provide their mobile phone numbers and to verify such mobile phone numbers by text message, or provide their names and national identification numbers, in each case to finish the registration process. If a game’s registration process can be completed by providing a fake identification number with a random name, then we regard this game as not complying with the real-name registration rules.

<sup>266</sup> Each Android version of the mobile game that we tested is downloadable through such mobile game’s official website. The real-name registration rule test is the same as the test for iOS versions of mobile games described above.

<sup>267</sup> The list of top fifty mobile games is based on voting by users on 17173.com on March 1, 2017. See “[17173 Mobile Game Ranking List](#)” (17173 手游排行榜) (Chinese).

<sup>268</sup> We checked compliance with value-added telecommunication license requirements on MIIT’s website: <https://tsm.miit.gov.cn/pages/home.aspx>

<sup>269</sup> We checked compliance with internet culture license requirements through MOC’s provincial level websites, such as Beijing MOC’s website: <http://www.bjwh.gov.cn/bjwh/bsfw/jggs/index.html>, and Guangdong Province MOC’s website: <http://www.gdwh.gov.cn/>

<sup>270</sup> We checked compliance with the online publishing service license requirements through SAPPRFT website: <http://www.gapp.gov.cn/govservice/1959.shtml>

网)			
Giant (巨人网络)	Yes	Yes	Yes
Shanda (盛大)	Yes	Yes	Yes
Kunlun (昆仑万维)	Yes	Yes	Yes
NetDragon (网龙)	Yes	Yes	Yes
YY (欢聚时代)	Yes	Yes	Yes
360 (奇虎 360)	Yes	Yes	Yes
Kingsoft (金山)	Yes	Yes	Yes
37 Interactive (37 互娱)	Yes	Yes	Yes
Youzu (游族网络)	Yes	Yes	Yes
Yodo 1 (游道易)	Yes	Yes	No
iDreamsky (乐逗 游戏)	Yes	Yes	Yes
<b>Compliance Rate</b>	<b>100%</b>	<b>100%</b>	<b>93.75%</b>

3. Mobile Game App Stores. The table below summarizes compliance with the rules regarding various license requirements by the leading Android mobile game app stores and China Apple App Store.

Mobile Game App Stores	Value-Added Telecommunication License <sup>271</sup>	Internet Culture License <sup>272</sup>	Online Publishing Service License <sup>273</sup>
MyApp (腾讯应用宝)	Yes	Yes	Yes
360 Cellphone Assistant (360 手机助手)	Yes	Yes	Yes
Baidu Cellphone Assistant (百度手机应用商店)	Yes	Yes	No
Xiaomi App Store (小米应用商店)	Yes	Yes	No

<sup>271</sup> We checked compliance with value-added telecommunication license requirements through MIIT's website: <https://tsm.miit.gov.cn/pages/home.aspx>

<sup>272</sup> We checked compliance with internet culture license requirements through MOC's provincial level websites, such as Beijing MOC's website: <http://www.bjwh.gov.cn/bjwh/bsfw/jggs/index.html>, and Guangdong Province MOC's website: <http://www.gdwh.gov.cn/>

<sup>273</sup> We checked compliance with online publishing service license requirements through SAPPRFT's website: <http://www.gapp.gov.cn/govservice/1959.shtml>

Wan Dou Jia (豌豆荚)	Yes	Yes	Yes
Huawei App Store (华为应用商店)	Yes	Yes	No
Hi Market (安卓网)	Yes	Yes	No
Vivo Cellphone Assistant (Vivo手机助手)	Yes	No	No
Oppo App Store	Yes	Yes	No
China Mobile Mobile Market (中国移动移动商城)	No	No	No
China Telecom Yi Store (中国电信易商店)	Yes	Yes	No
China Unicom Wo Store (中国联通沃商店)	Yes	Yes	No
Apple	No	No	No
<b>Compliance Rate</b>	<b>84.6%</b>	<b>77.1%</b>	<b>23.1%</b>

## TAX INCENTIVE REQUIREMENTS

In order to qualify as a high and new technology enterprise, a company must satisfy the following requirements:<sup>274</sup>

- (1) The company must have been established for one (1) year;
- (2) The company must own independent intellectual property for the core technologies in its key products and services;
- (3) The company's products and services must be within the prescribed scope as further described in "High and New Technology Fields Under the Key Support by the State" (国家重点支持的高新技术领域);<sup>275</sup>
- (4) Scientific and technical personnel with an educational background of junior college or higher must account for at least 10% of the total number of employees of the company;
- (5) The company must be carrying out research and development activities, and the ratio between its total research and development expenditures during the most recent three accounting years and its total sales revenue must meet the following requirements:
  - a) If the sales revenue of the company during the most recent year is less than RMB 50 million, the proportion shall not be lower than 5%;
  - b) If the sales revenue of the company during the most recent year is between RMB 50 million and RMB 200 million, the ratio shall not be less than 4%;
  - c) If the sales revenue of the company during the most recent year is more than RMB 200 million, the ratio shall not be less than 3%.

If the ratio between the total research and development expenditures incurred by the company within China and the total research and development expenditures incurred by the company globally is less than 60% and three years have not lapsed since the establishment of the company, the calculation shall be based on the actual number of years of business operation of the company.

- (6) The company's revenue from high and new tech products and services must account for at least 60% of its total revenue during the current year;
- (7) The company's innovation ability must satisfy the relevant requirements; and

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<sup>274</sup> Article 10 of Administrative Measures for the Determination of High and New Tech Enterprises (高新技术企业认定管理办法), jointly issued by Ministry of Science and Technology (科技部), Ministry of Finance (财政部) and State Administration of Taxation on January 29, 2016.

<sup>275</sup> Source: [MOFCOM website](#).

- (8) No serious safety accident, serious poor-quality accident or serious environment damage accident during the past one (1) year.

## LIST OF REGULATIONS

This list of regulations includes all rules and regulations that we cited in this primer, which covers almost all PRC rules and regulations that relate to China's digital game industry.

1. Opinions of the Supreme Court on Several Issues Concerning the Implementation of the General Principles of the Civil Law of PRC (最高人民法院印发《关于贯彻执行〈中华人民共和国民事诉讼法通则〉若干问题的意见(试行)》的通知), issued by the Supreme Court on April 2, 1988.
2. PRC Contract Law (合同法), issued by National People's Congress on October 1, 1999.
3. The Notice on Launching a Special Campaign against Illegal Electronic Game Rooms (国务院办公厅转发文化部等部门关于开展电子游戏经营场所专项治理意见的通知), issued by the General Office of the State Council in June 2000.
4. The Administrative Measures on Internet Information Services (互联网信息服务管理办法), issued by the State Council in September 2000.
5. Telecommunications Regulations of the People's Republic of China (中华人民共和国电信条例), issued by State Council in September 2000.
6. Telecommunications Regulations, the catalogue attached to the Telecommunications Regulations (电信条例(附《电信业务分类目录》)), issued by the State Council in September 2000.
7. Provision on the Administration of Electronic Bulletin Board Services on the Internet (互联网电子公告服务管理规定), issued by MIIT in October in 2000.
8. Measures for the Registration of Computer Software Copyright (计算机软件著作权登记办法), issued by NCAC on February 20, 2002.
9. The Notice of the Ministry of Culture on Enhancing the Supervision on Internet Culture Market (文化部关于加强网络文化市场管理的通知), issued by MOC on May 2002.
10. The Regulations on the Administration of Business Sites of Internet Access Services (互联网上网服务营业场所管理条例), issued by the State Council on September 29, 2002.
11. The Notice on Strengthening the Content Censorship of Online Games (文化部关于加强网络游戏产品内容审查工作的通知), issued by MOC in May 2004.
12. The Interim Provisions on the Administration of Internet Culture (互联网文化管理暂行规定), issued by MOC in May 2003, and amended in July 2004.
13. Notice on the Work of Purification of Online Games (关于净化网络游戏工作的通知), issued by MOC on June 9, 2005.
14. Several Opinions regarding the absorbing the Foreign Investment in Culture Regions (关于文化领域引进外资的若干意见), issued by MOC on July 6, 2005.
15. Some Opinions of the Ministry of Culture and the Ministry of Information Industry on the Development and Administration of Online Games (文化部、信息产业部关于网络

游戏发展和管理的若干意见), issued by MOC and MIIT on July 12, 2005.
16. Shanghai Electronic Game Rooms Management Test Work Plan (上海电子游戏经营场所管理试点工作方案), issued by Shanghai Municipal Administration of Culture, Radio, Film and TV on May 23, 2006.
17. Notice on Strengthening the Administration of Foreign Investment in the Operation of Value-Added Telecommunication Business (关于加强外商投资经营增值电信业务管理的通知), issued by MIIT on July 13, 2006.
18. The Notices Regarding Further Strengthening the Administration of Internet Café and Online Games (关于进一步加强网吧及网络游戏管理工作的通知), issued by 14 government departments including MOC, the State Administration For Industry and Commerce, the Ministry of Public Security, and MIIT on February 15, 2007.
19. The Income Tax Law of PRC (企业所得税法), issued by the National People's Congress on March 16, 2007.
20. The Notice on Protecting the Health of Minors by Adopting an Anti-fatigue System in Online Games , (关于保护未成年人身心健康实施网络游戏防沉迷系统的通知), issued by SAPPRFT, MIIT and six other departments of the State Council in April 2007.
21. The Administrative Provisions on the Publishing of Electronic Publications (电子出版物出版管理规定), issued by SAPPRFT in April 2008.
22. The Administrative Measures for the Determination of High and New Tech Enterprises (高新技术企业认定管理办法), issued by the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation on April 14, 2008.
23. The Regulation on the Responsibilities, Internal Structure and Personnel of the Ministry of Culture (文化部主要职责内设机构和人员编制规定), issued by the General Office of the State Council in July 2008.
24. The Regulation on the Responsibilities, Internal Structure and Personnel of the General Administration of Press and Publication (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), issued by the General Office of the State Council on July 11, 2008.
25. The Administration of Foreign-Invested Telecommunication Enterprises (外商投资电信企业管理规定), issued by the State Council in January 2001, and amended in September 2008.
26. Administrative Measures for Software Products (软件产品管理办法), issued by MIIT on March 1, 2009.
27. Administrative Measures for Telecommunications Business Operating Licenses (电信业务经营许可管理办法), issued by MIIT on March 5, 2009.
28. The Notice on Standardizing the Application and Review Work for Imported Online Games (关于规范进口网络游戏产品内容审查申报工作的公告), issued by MOC on April 24, 2009.
29. The Notice on Strengthening Administration of Virtual Currency in Online Games (关于加强网络游戏虚拟货币管理工作通知), issued by MOC and the Ministry of Commerce

in June 2009.
30. The State Commission Office for Public Sector Reform's Interpretation of the Provisions Concerning Animation, Online Game and Law Enforcement in the Cultural Market in the General Administration of Press and Publication, the Ministry of Culture and the State Administration of Radio Film and Television Three Determinations Regulation (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), issued by the State Commission Office for Public Sector Reform in July 2009.
31. The Notice on Implementing the Three Determinations Regulations and the Reform Commission Interpretation and Strengthening the Preapproval of Online Games and Administration of Imported Online Games (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), issued by SAPPRFT in September 2009.
32. Notice on Improving and Strengthening the Administration of Content in Online Games (文化部关于改进和加强网络游戏内容管理工作的通知), issued by MOC on November 13, 2009.
33. The Notices Regarding Further Strengthening the Administration of Internet Cafés and Online Games and the Notice Regarding Increasing the Punishment for Internet Cafés that Admits Minors (文化部关于加大对网吧接纳未成年人违法行为处罚力度的通知), issued by MOC on March 13, 2010.
34. The Interim Provisions on the Administration of Online Games (网络游戏管理暂行办法), issued by MOC in June 2010.
35. The Notice Regarding Prohibiting Game Companies from Using Vulgar Methods to Promote the Sale of Online Games (文化部文化市场司关于加强网络游戏市场推广管理 制止低俗营销行为的函), issued by MOC on July 7, 2010.
36. Notices Regarding the Implementation of the Interim Provisions on the Administration of Online Games (关于贯彻落实《网络游戏管理暂行办法》有关规定的通知), issued by the Ministry of Culture Shanghai Office on July 27, 2010.
37. The Requisite Standard Clauses for Online Game Service Agreement (网络游戏服务格式化协议必备条款), issued by the Ministry of Culture on July 30, 2010.
38. The Implementation Plan of the Online Game Parental Control Project for Minors (“网络游戏未成年人家长监护工程”实施方案), issued by eight government departments including the Ministry of Public Security and the MOC on January 15, 2011.
39. Several Policies on Further Encouraging the Development of the Software and Integrated Circuit Industries (进一步鼓励软件产业和集成电路产业发展的若干政策), issued by the State Council on January 28, 2011.
40. Tentative Measures for Administration of Internet Culture (互联网文化管理暂行规定), issued by MOC on March 21, 2011.
41. Notice on Issues Relating to the Implementation of the Tentative Measures for Administration of Internet Culture (文化部关于实施新修订《互联网文化管理暂行规

定》的通知), issued by MOC on March 21, 2011.
42. The Notice Regarding China Initiates Work for the Online Game Real-Name System (关于启动网络游戏防沉迷实名验证工作的通知), issued by eight government departments including the SAPPRFT and the Ministry of Public Security on July 1, 2011.
43. Several Opinions of the State Council on Supporting the Construction of Kashi Horgos Economic Development Zone (国务院关于支持喀什霍尔果斯经济开发区建设的若干意见), issued by the State Council on October 8, 2011
44. Several Provisions on Regulating the Market Order of Internet Information Services (规范互联网信息服务市场秩序若干规定), issued by MIIT on December 29, 2011.
45. The Implementation Plan of the Public Electronic Reading Rooms Construction Plan (“公共电子阅览室建设计划”实施方案), issued by MOC and the Ministry of Finance on February 3, 2012.
46. Notice of the Tentative Instructions to the Administration of Internet Culture Market (文化部关于印发《网络文化市场执法工作指引(试行)》的通知), issued by the Ministry of Culture on September 24, 2012.
47. Decision to Enhance the Protection of Network Information (全国人民代表大会常务委员会关于加强网络信息保护的決定), issued by Standing Committee of the National People’s Congress on December 28, 2012.
48. Rules of Protection on Information Network Dissemination Rights (《信息网络传播权保护条例》根据 2013 年 1 月 30 日《国务院关于修改〈信息网络传播权保护条例〉的決定》修订), issued by the State Council in January 30, 2013.
49. Work Plan for the Integrated Prevention of Minor Online Game Addiction (文化部、国家互联网信息办公室、工商总局、公安部、工业和信息化部、教育部、财政部、监察部、卫生部、中国人民银行、国务院法制办公室、新闻出版总署、中央文明办、中央综治办、共青团中央关于印发《未成年人网络游戏成瘾综合防治工程工作方案》的通知), jointly issued by 15 government authorities on February 5, 2013.
50. Notice to Implement Change from Business Tax to Value-Added Tax Pilot Zone Management Nationally (关于在全国开展营业税改征增值税试点有关征收管理问题的公告), issued by State Administration of Taxation (国家税务总局) on July 10, 2013.
51. Order for the Protection of Telecommunication and Internet User Personal Information (《电信和互联网用户个人信息保护规定》发布), issued by MIIT on July 16, 2013.
52. Notice of the Ministry of Culture on Implementing the Administrative Measures for the Content Self-examination of Internet Culture Business Entities (文化部关于实施《网络文化经营单位内容自审管理办法》的通知), issued by MOC on August 12, 2013.
53. Notice of the Ministry of Culture on the Management of Online Operation of Internet Culture Entities (文化部办公厅关于开展网络文化经营单位上线运行管理工作的通知), issued by MOC on December 24, 2013.
54. Decisions of the State Council on Temporary Adjustment on the Related Regulations with respect to the Approval or Admission of Foreign Investment in (Shanghai) Pilot

Free Trade Zone (国务院关于在中国（上海）自由贸易试验区内暂时调整有关行政法规和国务院文件规定的行政审批或者准入特别管理措施的决定), issued by the State Council on January 6, 2014.
55. Decisions of the MIIT on further opening of value-added telecommunications service in (Shanghai) Pilot Free Trade Zone (关于中国（上海）自由贸易试验区进一步对外开放增值电信业务的意见), issued by MIIT on January 6, 2014.
56. Implementation Rule of the Opening of Culture Market in (Shanghai) Pilot Free Trade Zone (中国（上海）自由贸易试验区文化市场开放项目实施细则), issued by Shanghai Municipal Government on April 10, 2014.
57. Notice of Further Standardizing the Application Materials for Foreign Copyright Owner Authorizing Internet Games and Electronic Game Publications (关于进一步规范出版境外著作权人授权互联网游戏作品和电子游戏出版物申报材料的通知), issued by SAPPRFT on April 18, 2014.
58. Notice on Strengthening of Law Enforcement and Supervision, Perfect Management Policies and Promoting the Healthy and Orderly Development of The Internet Service Industry (关于加强执法监督 完善管理政策 促进互联网上网服务行业健康有序发展的通知), issue by MOC on November 24, 2014
59. Notice of the State Council on Promoting the Replicable Experience from the Pilot Reform in China (Shanghai) Pilot Free Trade Zone (国务院关于推广中国（上海）自由贸易试验区可复制改革试点经验的通知), issued by the State Council on December 14, 2014.
60. PRC Foreign Investment Law (Draft for Public Comments) (中华人民共和国外国投资法（草案征求意见稿）)
61. Foreign Investment Catalogue (Amended in 2015) (外商投资产业指导目录（2015 修订）), issued by the State Council on March 10, 2015.
62. Notice on Allowing Domestic and Foreign-funded Enterprises with Production and Sale of Game and Entertainment Devices (文化部允许内外资企业从事游戏游艺设备生产和销售的通知), issued by MOC on June 24, 2015.
63. Interim Provisions of E-Sports Competition Management (电子竞技赛事管理暂行规定), issued by GASC on July 24, 2015.
64. Counter-Terrorism Law of the People’s Republic of China (中华人民共和国反恐怖主义法), issued by the Standing Committee of the National People’s Congress on December 27, 2015.
65. Notice of MIIT Adjusting the <Classification Catalogue of Telecommunication Service (2015 Edition)> (信息产业部关于调整《电信业务分类目录的（2015年版）》的通知), issued by MIIT on December 28, 2015.
66. Administrative Measures for the Determination of High and New Tech Enterprises (高新技术企业认定管理办法), issued by Ministry of Science and Technology, Ministry of Finance and State Administration of Taxation on January 29, 2016.

67. Administrative Provisions on Online Publishing Service (网络出版服务管理规定), issued by SAPPRFT and MIIT on February 4, 2016.
68. Circular of the State Administration of Foreign Exchange on Reforming the Management Approach regarding the Settlement of Foreign Exchange Capital of Foreign-invested Companies (国家外汇管理局关于改革外商投资企业外汇资本金结汇管理方式的通知), issued by the State Administration of Foreign Exchange (国家外汇管理局) on March 30, 2016.
69. Specification of Mobile Game Content (2016 Edition) (移动游戏内容规范 (2016年版)), issued by CADPA on May 24, 2016.
70. Notice Regarding the Administration of Mobile Game Publication Services (关于移动游戏出版服务管理的规定), issued by SAPPRFT on May 24, 2016.
71. Regulations for the Administration of Mobile Apps Information Service (移动互联网应用程序信息服务管理规定), issued by CAC on June 28, 2016.
72. Cyber Security Law of the People's Republic of China (中华人民共和国网络安全法), issued by the Standing Committee of the National People's Congress on November 6, 2016.
73. Notice on the Improvement of the Preferential List of Income Tax Preferential for the Enterprises in Encouraged Industrial in Xinjiang Difficult Areas (关于完善新疆困难地区重点鼓励发展产业企业所得税优惠目录的通知), issued by the Ministry of Finance and other four department on September 2, 2016.
74. Opinion of Promoting Culture and Entertainment Industry Transformation and Upgrading (文化部关于推动文化娱乐行业转型升级的意见), issued by MOC on September 21, 2016.
75. Administrative Provisions on Live Streaming Service (互联网直播服务管理规定), issued by CAC on December 1, 2016.
76. Notice of Interim and Post-Event Supervision of Regulating Online Game Operation (关于规范网络游戏运营加强事中事后监管工作的通知), issued by MOC on December 5, 2016.
77. Administrative Measures on Online Performance Business Operation Management (网络表演经营活动管理办法), issued by MOC on January 1, 2017.
78. Regulations on Protection of Minors Online (Pre-Approval Draft) (未成年人网络保护条例 (送审稿)), issued by State Council on January 6, 2017.
79. Notice of the State Council on Several Measures Concerning the Expansion of Opening-up and the Active Use of Foreign Capital (国务院关于扩大对外开放积极利用外资若干措施的通知), issued by the State Council on January 12, 2017.