

Shanghai FTZ and Liberalization of China's Gaming Console Industry

By David Yu and Teddy Li

The *Notice of the State Council on the Issuance of the Framework Plan for the China (Shanghai) Pilot Free Trade Zone* (the "Framework Plan") adopted on 3 July 2013 expressly provides that "foreign-invested enterprises will be allowed to engage in the manufacturing and sales of entertainment and gaming consoles. The consoles with content passing the censorship by the culture administrative authorities will be allowed to be sold in the domestic market". This signifies that the doors to China's gaming console market have finally been opened to foreign investors.

Regulations in Effect

Pursuant to the *Opinions on Launching Rectification on Venues That Operate Electronic Games* (ref. *Guo Ban Fa* [2000] No. 44) of the Ministry of Culture and six other ministries forwarded by the General Office of the State Council in 2000 and Notice *Xin Chu Lian* [2009] No. 13 on further strengthening the advance approval of online games and the approval of imported online games issued by the General Administration of Press and Publishing, the National Copyright Administration, etc. in 2009, no enterprise or individual may engage in the production or sale of electronic gaming consoles or parts and components thereof targeted at the domestic market and foreign investors are prohibited from investing and engaging in online game operation services in China in the form of wholly foreign-owned enterprises, equity joint ventures, cooperative joint ventures, etc.

However, both the Framework Plan and the *Notice on Implementing the Policies for the Administration of the Culture Market in the China (Shanghai) Pilot Free Trade Zone* issued by the Ministry of Culture on 29 September 2013 expressly permit foreign-invested enterprises to engage in the manufacturing and sales of entertainment and gaming consoles in the Pilot Free Trade Zone (the "FTZ"), and further permit sales thereof on the domestic market if the devices pass the content censorship by the culture administrative authorities.

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On 6 January 2014, the State Council further issued the *Decision of the State Council on Provisionally Adjusting in the China (Shanghai) Pilot Free Trade Zone Administrative Approvals and Special Administrative Measures for Access Specified in Relevant Administrative Regulations and State Council Documents*. Article 32 of the Decision specifies that implementation of Articles 2 and 6 of Opinion *Guo Ban Fa* [2000] No. 44 is temporarily suspended in the FTZ, and the culture authority of the State Council will formulate relevant administrative measures so as to permit foreign-invested enterprises to engage in the manufacturing and sales of entertainment and gaming consoles in the FTZ, and sell thereof to the domestic market if it passes the content censorship by the culture administrative authorities. This decision of the State Council is consistent with the Framework Plan and the complementary regulations of the Ministry of Culture and further announces that the prohibition on the manufacturing and sales of gaming consoles is removed in the FTZ.

Upon the issuance of the above mentioned policies and regulations, Shanghai E-Home Entertainment Development Co., Ltd. ("Shanghai E-Home"), as an equity joint venture between BesTV and Microsoft, became the first such type of enterprise in the FTZ. According to information disclosed by BesTV, Shanghai E-Home has a total investment of US\$79 million, with BesTV accounting for 51 percent of the shares and Microsoft 49 percent. Shanghai E-Home's scope of business, including the wholesale, licensing, marketing as well as the design, development and production of self-developed and third party game and entertainment application software, shows that Shanghai E-Home not only intend to develop gaming consoles, but is also interested in the wider market for the business of game and entertainment application software.

Awkward Situation in the Midst of Liberalization

Despite the foregoing relaxation, the current policy in the FTZ on online game services, such as online battle platforms, remains completely closed.

As early as 2002, Microsoft released Xbox-LIVE, an online battle platform for the Xbox series of home gaming consoles, providing users with services such as purchase and download of games, online games, voice chat, etc. However, for Xbox users, Xbox-LIVE has not really entered the Chinese market. Except the app store, the services offered by Xbox-LIVE, such as the game online battle platform, etc., are expressly prohibited by the Negative List.

The Negative List specifies that foreign investors are prohibited from directly or indirectly engaging and participating in online game operation services. As there is no official interpretation on this provision, reference can be made to Article 4 of Notice *Xin Chu Lian* [2009] No. 13 which specifies that, "foreign investors shall not directly control or participate in the online game operation business of domestic enterprises through indirect means such as the establishment of other joint ventures, execution of relevant agreements or the provision of technical support. Neither shall they control nor participate in the online game operation business in a disguised manner through means such as user registration, account management, time card spending, etc. which directly give rise to gaming networks, battle platforms, etc. that are actually controlled by or the ownership of which belongs to foreign investors".

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It can be said that Microsoft at present faces an awkward situation where its hardware can enter the market but its software is blocked. The Negative List partially removed the prohibition on the game industry, but the market participants may still lack motivation to enter the Mainland China market through the FTZ.

The New Version of the Negative List

Previously, numerous people in the industry expressed their disappointment on the 2013 version of the Negative List, one of the reasons being its remarkable resemblance with the *Catalog for Guiding Foreign Investment in Industry* issued in 2011 and the relatively minor degree of liberalization it contains. In addition, problems such as unclear interpretation of the List also exist. The good news is that the 2014 version of the Negative List is currently open for comments and, according to some insiders, the new version of the Negative List provides all restrictions on foreign investment imposed at a ministerial level, which will finally be determined, item by item, after discussions with the relevant ministerial level authorities.

Given the current situation where game terminal products have been liberalized but online games and game battle platforms remain restricted, foreign gaming console manufacturers are eagerly waiting for the 2014 version of the Negative List. From a regulatory and policy perspective, we are looking forward to further clarification and regulation of the restrictions on foreign investment in the gaming console industry, conducive to the healthy development of this industry.

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This article was first published in *China Business Law Journal*, February 2014, Volume 5, Issue 2.