

Conducting Free Online Prize Raffles in China – Regulatory Restrictions for Foreign Investors

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I. Introduction

Many companies offer online prize raffles on their websites in which internet users can participate for free. The purpose of such prize raffles are manifold; promoting and marketing products, generating and collecting consumer data for further use, market and scientific research etc.

This article discusses some regulatory issues a foreign company needs to face when it intends to offer free online prize raffles for Chinese Internet users.

II. Legal Background

In China, any form of gambling, whether on- or offline, is prohibited. Individual participation in gambling violates Public Security Administrative Regulations whereas organizing gambling for the purpose of making profit constitutes a criminal act under the PRC Criminal Law that may be punished with up to ten years imprisonment.

As opposed to gambling, gaming activities are generally not prohibited. Operation of games, however, is subject to certain restrictions as further described below.

III. Prize Raffles – Legal Gaming or Illegal Gambling?

Under PRC law, gambling is defined as an act of playing for stakes in the hope of winning which results in either a gain or a loss. The potential loss must be a monetary loss. Thus, three elements characterize gambling: (1) opportunity to win a prize, (2) winning based on chance, and (3) potential to make a monetary loss. An activity that does not fulfill any of these three criteria does generally not qualify as gambling. For instance, a contest is based on the level of the participants' skill whereas the winner in gambling is determined by chance. Prize raffles, in turn, always include the elements of prize and chance. Therefore, in order not to fall into the category of gambling there must be no potential for the participant to incur monetary loss. In practice, this means no monetary consideration to buy the chance of winning (see Anthony N. Cabot/Glenn J. Light/Karl F. Rutledge, *Economic Value, Equal Dignity and the Future of Sweepstakes*, *UNLV Gaming Law Journal*, 20 July, 2010, p. 2, 12. Under the U.S. approach, gaming requires a consideration of economic value from the participant to buy the chance to

win, either directly or indirectly through purchasing a product or service).

On the other hand, an activity with the elements prize and chance but without potential of monetary loss is considered gaming. Thus, the following general statements can be made for prize raffles: A prize raffle in which a player must make a monetary consideration in order to buy the chance of winning (e.g. buy a raffle ticket) qualifies as gambling and violates PRC regulations. Prize raffles offered for free are generally allowed but must satisfy the regulatory requirements for gaming.

IV. Operating Online Games - Regulatory Requirements

A. No Foreign Direct Investment

Whether the operation of gaming activities is open for foreign investment depends on the categorization of gaming in the Catalogue of Guidelines on Foreign Investment (the “Catalogue”). The Catalogue divides foreign investment in various industrial sectors into four categories: (1) promoted, (2) permitted, (3) restricted, and (4) prohibited.

According to the Catalogue, foreign direct investment in the field of (on- and offline) gaming including raffles is prohibited. Accordingly, a foreign company may not invest in a local company that operates online games or directly set up its commercial presence in China (whether as a representative office, subsidiary or in any other form) to conduct business in this area.

B. Contractual Cooperation with local Chinese Company

A foreign company that wants to conduct online games in China needs to cooperate (on a contractual basis) with a local Chinese company that is a so-called local “Internet Cultural Operation Entity”. Only an “Internet Cultural Operation Entity” is allowed to conduct (on- or offline) games in China. As mentioned above, the cooperation between the foreign and the local Chinese company may not take the form of equity cooperation (i.e. no joint ventures).

C. Licensing Requirements for the local Chinese Company

In order for a local Chinese company to qualify as “Internet Culture Operation Entity” it needs to be in possession of an Internet Cultural Operation License (网络文化经营许可证). This License must be obtained by the PRC Ministry of Culture or its local corresponding branch at provincial level.

Furthermore, developing online games accessible to the public via the internet is regarded as an online game publishing activity. Therefore, an “Internet Cultural Operation Entity” seeking to operate online games also needs to obtain an Internet Publishing Services License (互联网出版服务许可证) issued by the PRC General Administration of Press and Publication covering the service scope of the specific online game.

As a side note, a Chinese company issuing virtual game currency and providing transactional services regarding virtual game currency for other game operating companies only needs to obtain the Internet Cultural Operation License. Since they do not actually publish anything no Internet Publishing Services License is required.

If a game (including free prize raffles) is not operated with the purpose of making profit, the regulatory requirements are substantially simpler. In this case, the “Internet Culture Operation Entity” only needs a recordation (非经营性互联网信息服务备案) for non-profit making internet information services. Free prize raffles aiming at promoting and marketing products or generating and collecting consumer data are generally considered profit-oriented. Non-profit oriented would be, for instance, a research program conducted for purely scientific purposes without economical intent.

Foreign investors do not deal with the above mentioned license applications themselves. Their local game operator undertakes those procedures. Typically, a foreign copyright owner of imported online games generally must grant its Chinese online game operator(s) the exclusive right to operate the online games in China.

D. Regulatory Approval for Online Game

In practice, before a foreign imported online game can be launched in China, the “Internet Culture Operation Entity” has to obtain approval from the PRC General Administration of Press and Publication and the PRC Ministry of Culture with regard to the content of the game.

V. Other Regulations for Online Gaming

For online gaming, the Chinese authorities recently enacted new laws regarding the protection of minors. According to these regulations, online games intended for minors must not contain content which encourages minors to imitate criminal behavior or is against the interests of society. Content involving horror or cruelty which could impair the physical and mental well-being of minors is also prohibited.

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