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China's Supreme People's Court Releases its First Decision Under China's Antimonopoly Law

Case sets precedent for antitrust disputes in China, particularly on how to define the relevant market, and assess market dominance and abusive conduct.

Introduction

On 16 October 2014, China's highest court announced its decision in the landmark antitrust case between internet companies Beijing Qihoo Technology Co. Ltd. (Qihoo) and Tencent Technology (Shenzhen) Co. Ltd and Shenzhen Tencent Computer System Co., Ltd (collectively, Tencent). This is the Supreme People's Court's (SPC) first decision under China's Antimonopoly Law (AML) since it came into effect in 2008.

Background

Qihoo is a leading provider of anti-virus and security software in China, known for its anti-virus program, 360 Safeguard. Tencent is a leading provider of comprehensive internet services in China, known for its social networking, micro-blogging, and instant messaging software platforms such as WeChat, Weibo and QQ.

In 2010 Tencent introduced an anti-virus program called "QQ Computer Housekeeper," which competed directly with Qihoo. Tencent started to encourage users of its QQ instant messaging service to download the upgraded version of its security software. At around the same time, Qihoo launched new software designed to protect the user's privacy and block Tencent's QQ pop-up ads on devices using Qihoo's software. Qihoo later published an article alleging that its software had detected that some instant messaging software was violating the privacy of users, and implicitly accused Tencent of scanning its users' computers for private data. In response, Tencent warned QQ users that the use of the Qihoo software was incompatible with its QQ instant messaging service. Tencent issued a letter to the QQ users indicating that they would not provide relevant software services to those users who installed the Qihoo software, and requested them to uninstall the Qihoo software.

In 2011 Qihoo filed a private antitrust lawsuit against Tencent before the Guangdong High People's Court (the first instance court), accusing Tencent of anti-competitive behavior by: (i) exclusive dealing in requiring its users choose between uninstalling Qihoo software from their devices or losing functionality of the QQ instant messaging service, and (ii) tying "QQ Computer Housekeeper" with the QQ instant messaging service.

On 28 March 2013, the first instance court ruled that Tencent had not violated the AML, dismissing Qihoo's claims. The first instance court held that Qihoo had failed properly to identify the relevant product and geographic markets and that there was insufficient evidence that Tencent held a dominant market position in instant messaging. Qihoo appealed the decision of the first instance court to the SPC.

The SPC Decision

Whilst correcting the first instance court on several issues, the SPC affirmed the original ruling that Tencent had not violated the AML, and dismissed Qihoo's appeal.

The SPC's ruling addressed key issues, including:

- How to define the relevant market
- Whether Tencent held a dominant position in the relevant market
- Whether Tencent had violated the AML by abusing a dominant position in the relevant market
- Whether the first instance court committed any procedural errors
- The civil liability of Tencent (*i.e.,* whether Qihoo had suffered economic loss in the sum of RMB825 million, and was entitled to compensation in the sum of RMB150 million)

Relevant market

The SPC noted the free nature of the internet market, and decided that the hypothetical monopolistic test (HMT) based on upward price rises is not applicable in this case. The SPC therefore determined that the first instance court erred in applying the small but significant and non-transitory increase in price (SSNIP) test in defining the relevant market. This finding could be considered controversial, as the SSNIP test is almost universally accepted across the globe as the relevant test. However, the SPC explained the basis on which it did not adopt the SSNIP test in this instance.

In its judgment, the SPC noted that, in addition to SSNIP, other tests, such as SSNDQ (small but significant and non-transitory decrease in quality) can be applied in defining the relevant market. The SPC considered that the applicable test will depend on the specific circumstances of each case, considering the competition in the relevant market as well as the availability of the relevant data. If the products offered in the relevant market are homogeneous or commoditized such that competition mainly focuses on price, then the SSNIP will be considered as a more appropriate test for defining the relevant market. However, applying the SSNIP test to define the relevant market is more difficult if the products offered in the relevant market are highly differentiated and compete by reference to their respective quality, services, innovation and consumer experience. In particular, the SPC noted that, if the products offered in a particular market are generally free of charge, a small numerical increase in price would, in effect, be an infinite increase. Such a change in price would likely result in a significant change in product features and/or the business models adopted in the relevant market, making the SSNIP test difficult to apply.

The SPC reasoned that the free nature of the internet market had existed for such a substantial period of time that the free nature had now become a prevailing business model. Replacing this free nature for the receipt of even a small fee could lead to a large loss of users. In these circumstances, applying the SSNIP test would quite likely cause products and/or services — which cannot in truth be considered as substitutes — to fall into the same relevant market, thus adopting such a test would be inappropriate.

In relation to the product boundary of the relevant market, the SPC agreed with the first instance court's decision that the relevant market should include (i) PC-based and mobile instant messaging services; and (ii) both comprehensive and non-comprehensive instant messaging services (such as text, audio and visual instant messaging). The SPC also affirmed the first instance court's decision that such a market should not include emails and mobile phone text messages. However, whilst the SPC accepted that the instant messaging services offered by social networking sites and microblogs should be included in the relevant market, the SPC disagreed with the first instance court's finding that the relevant market should include social networking and microblog services as a whole.

As regards the geographic scope of the relevant market, the SPC determined that the first instance court erred in finding that the relevant market was global. In this regard, the SPC noted:

- Most instant messaging service users in mainland China subscribed to instant messaging services offered by providers operating in mainland China

- Overseas instant messaging service providers could only enter into the instant messaging service market in mainland China by way of joint venture and upon obtaining all necessary administrative approvals and permits. The SPC noted that many major overseas instant messaging service providers had already entered into the mainland China market via joint ventures before the dispute between Qihoo and Tencent arose

The SPC therefore found that the correct geographic boundary of the relevant market was mainland China.

However, the SPC held that a court need not define the boundaries of the relevant market clearly and precisely in every market dominance case. Instead, the definition of the relevant market is to be used as a tool to assess the parties’ market positions and the impact of the alleged monopolistic conduct on competition. The SPC held that, in the specific circumstances of this case, as the first instance court had essentially determined what should constitute the relevant market, the first instance court’s failure to identify the boundaries of the relevant market conclusively did not amount to a failure to make a finding of the basic facts.

Market dominance

The SPC acknowledged that Tencent had a greater than 80 percent share of both the PC-based and the mobile instant messaging service markets. Notwithstanding this, and Article 19 of the AML (which stipulates that a business operator may be presumed to have a dominant market position when its market share accounts for 50 percent or more of the relevant market), the SPC concluded that the evidence was insufficient to prove Tencent's dominance of the market.

The SPC looked at several other factors contained in Article 18 of the AML to assess dominance in addition to market share, including:

- The market competition situation

- The capacity of the subject business operator to control sales price, volume or other trading conditions

- The barriers to market entry

- The financial and technology capacity of the subject business operator

- The reliance of other business operators on the subject business operators

In considering these factors, the SPC determined that the instant messaging market is fully competitive and Tencent cannot substantially control sales price, quality, quantity or other trading conditions to restrict competition. The SPC also found that Tencent's financial and technology capacity is limited. The SPC therefore rejected Qihoo's contention that Tencent holds a dominant position in the market.

Abuse of market position

The SPC also rejected Qihoo's contention that Tencent had abused its market position. Pursuant to Article 17 of the AML, business operators are prohibited from abusing their dominant market position by restricting trading counterparts to dealing exclusively with them (or designated business operators), implementing tie-in sales, or imposing unreasonable trading conditions, without justification.

The SPC noted that the motive behind Tencent's conduct — warning that the use of Qihoo's software was incompatible with the use of Tencent's QQ instant messaging service and requesting users to uninstall Qihoo's software — was not clear. The SPC also noted that such behavior only lasted for one day.

The SPC found that, when assessing whether a business operator has abused its market position, a court ought to consider the potential positive impact of the subject business operator's conduct on consumers and market competition, as well as the conduct's potential negative impact. The SPC noted that the AML's focus of concern is not to protect the interests of individual business operators, but to protect a healthy market competition mechanism from being distorted or destroyed.

The use of the term "distorted" has caused some controversy in the European Union, because of its potentially broad meaning. In this decision, the SPC did not define the term "distorted". Relying on the market data the parties provided, the SPC concluded that the impact of Tencent's conduct on the anti-virus software market was minimal, and did not result in any "significant exclusion or restriction of competition in the anti-virus software market."

The SPC therefore held that Tencent's conduct did not constitute monopolistic behavior, adding that no evidence showed that Tencent's behavior resulted in a sharp decline of market share for Qihoo or other anti-virus software competitors.

The SPC also noted that no reliable evidence showed that the tying arrangement extended Tencent's market power in the instant messaging market to the anti-virus software market. Further, installing "QQ Computer Housekeeper" software with QQ instant messaging software made logical sense as it allowed users to manage the instant messaging software better, ensuring user protection, and increasing the value and performance of QQ instant messaging.

Procedural errors and civil liability

The SPC found that the first instance court had not committed any procedural errors, and that determining Tencent's civil liability was not necessary.

The Effect on China's AML Regime

The SPC's landmark ruling suggests that the court will take a cautious and effects-based approach in assessing anti-competitive behavior in the fast-growing internet sector, and perhaps more broadly.

As the SPC's first ruling in a case involving China's AML, the case sets a legal precedent for antitrust disputes in China, particularly in relation to the way in which to define the relevant market, and in the assessment of market dominance and abusive conduct.

The evidence of abuse in this case appears to have been weak (just one day of conduct), making it difficult to assess the level of proof of abuse that might be required in other cases. However, the SPC's detailed and careful analysis of antitrust issues in a manner largely consistent with courts in other jurisdictions is encouraging, as is the SPC's adoption of an effects-based test for abuse. On this, the SPC appears to have turned its face against the heavily criticized, more formalistic approach adopted in some other jurisdictions on the question of defining abuse, where the competitive effects are not considered when assessing allegations of abusive conduct.

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