

THE TAKEAWAY

In Guiding Case No. 78, *Beijing Qihu Technology Co., Ltd. v. Tencent Technology (Shenzhen) Company Limited et al.*,¹ the Chinese Supreme People's Court ("SPC") established authoritative guidance in the proper application of China's *Anti-Monopoly Law*² to the evolving field of internet technology. The decision illuminates the SPC's carefully considered approach to questions of market definition and market dominance in the technology field. Jurists inside and outside China will find this approach useful.

HON. JOHN M. WALKER, JR.,

is a Senior Circuit Judge, and was formerly Chief Judge (2000–2006), of the United States Court of Appeals for the Second Circuit, based in New York City. He joined the Court of Appeals in 1989. The Court is known for its antitrust expertise and Judge Walker has authored a number of opinions on the subject. He has served as the China liaison on the Committee on International Judicial Relations of the Judicial Conference of the United States and has participated in conferences and lectured widely in China for nearly two decades. His prior experience included service as a district judge, an Assistant Secretary of the Department of the Treasury, a federal prosecutor, and a litigator in the private sector.

In *Qihu v. Tencent*, the Chinese Supreme People's Court Offers Antitrust Insight for the Digital Age

*Hon. John M. Walker, Jr.**

THE RUNDOWN

Beijing Qihu Technology Co., Ltd. ("Qihu") and Tencent Technology (Shenzhen) Company Limited ("Tencent") are two of the largest internet companies in China. Qihu is a subsidiary of Qihoo 360 Technology Co., Ltd., which provides free online and mobile security through anti-virus software known as 360 Safeguard; it also provides a number of free web-based applications and services, including a web browser, a search engine, and an online gaming platform. Tencent also provides free internet-based apps and services, including QQ (an instant messaging platform), Weibo (a micro-blogging site similar to Twitter), and online gaming. Both Qihu and Tencent leverage their free services to build large user bases and then monetize those bases through advertising and the sale of additional products.

In 2010, Tencent introduced its own security software, called QQ Doctor, in competition with 360 Safeguard, and quickly captured a significant share of the market. Qihu retaliated by blocking Tencent advertisements on 360 Safeguard-equipped devices. Tencent in turn rendered its QQ instant messaging program inoperable on devices equipped with 360 Safeguard, effectively forcing users to switch to QQ Doctor if they wished to continue using the instant messenger service.

Qihu sued Tencent in the Higher People's Court of Guangdong Province, seeking RMB 150 million in damages



based on its allegation that Tencent had violated China's *Anti-Monopoly Law* ("AML") by "abusing" its "dominant position". In 2013, the Guangdong court dismissed the suit, holding that Tencent did not have a dominant market position and therefore did not violate the AML.

Qihu's appeal was the first instance in which China's Supreme People's Court ("SPC") was asked to adjudicate the meaning of the term "relevant market" in the AML. In reviewing the Guangdong court's holding, the SPC therefore had to provide guidance on how to analyze the three core inquiries of an antitrust suit: (1) what is the "relevant market" in which the defendant company competes?; (2) how should courts analyze whether the defendant has a "dominant" position in that market?; and (3) what evidence is relevant to determining whether the defendant "abused" that dominant position? In

addition, given the nature of the parties' businesses, the SPC was required to address whether the general principles of antitrust law varied in the specific context of internet-based competition.

The SPC affirmed the Guangdong court's dismissal of Qihu's suit. With respect to the first inquiry, defining the "relevant market", the SPC endorsed the widely-used "Hypothetical Monopolist Test" ("HMT"). Under the HMT, the "relevant market" is defined as a product or group of products in a particular geographic area for which consumers have no adequate substitute, such that if a particular company were the sole producer of that product, it could either raise prices or decrease quality while increasing profit. The SPC noted that because many internet-based products (including those of Qihu and Tencent) are free to consumers, in such cases courts

should apply the HMT by focusing on hypothetical decreases in quality rather than increases in price, which are unlikely to occur. In this case, the SPC held that the relevant market was internet instant messaging services.

With respect to the second inquiry, the SPC held that courts should apply a multi-factor test to determine whether a particular firm has a "dominant" position in the relevant market. These factors include the firm's market share, the legal and economic barriers to competitors entering the market, and the status of competition. The SPC noted that market share alone might be an unreliable indicator of market dominance in the internet sector because it is "highly dynamic and the boundaries of the relevant market are far less clear than those in traditional sectors."

The court concluded that Tencent did not occupy a "dominant" position in the instant messaging market.

Because the SPC determined that Tencent did not occupy a dominant market position, it devoted less attention to the third inquiry, which focuses on "abuse" of market dominance. However, the court did note that where market boundaries are unclear, direct evidence of anti-competitive behavior could suffice to prove a violation of the AML.

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THE BREAKDOWN

In addition to providing guidance to Chinese courts on how to apply the AML, Guiding Case No. 78 (“*Qihu*”) contains an important analysis by China’s highest court of how rapid advances in internet technology have affected antitrust law. In the United States, courts and regulatory agencies have confronted similar questions, though to date they have not significantly altered the law from that applicable prior to the advent of modern computer technology.³ Were a case of similar magnitude to be litigated in an American court (imagine, for instance, an antitrust suit between Google and Facebook in which one company accused the other of using its free web-based platform to engage in anti-competitive behavior), it would almost certainly result in a precedent-shaping opinion.

To consider how an American court might resolve a suit such as *Qihu v. Tencent*, it is useful to examine the closest analog in U.S. law, the District of Columbia Circuit’s landmark 2001 en banc opinion in *United States v. Microsoft*.⁴ In that case, the United States Department of Justice (“DOJ”) accused Microsoft of engaging in unfair business practices that were similar to those that *Qihu* accused Tencent of employing. DOJ claimed that Microsoft had leveraged the popularity of its Windows operating system (much as Tencent had allegedly done with its QQ instant messenger) to suppress competition in the growing market for internet browsers by employing a combination of technological strategies and restrictive licensing agreements to force Windows users into installing Microsoft’s Internet Explorer (“IE”) to the exclusion of competing browsers, such as Netscape Navigator. If a consumer wanted a Windows-operated computer (and, at the time, Windows controlled upwards of 95% of the market for operating systems on Intel-powered personal computers), that consumer was effectively forced to use IE to browse

the internet. DOJ argued that this arrangement violated Sections 1 and 2 of the Sherman Antitrust Act, 15 U.S.C. §§ 1, 2, which ban “contract[s], combination[s] [...] or conspirac[ies] in restraint of trade” and “monopoliz[ing], or attempt[ing] to monopolize[, ...] any part of [...] trade or commerce”, respectively.

Like China’s AML, the Sherman Act is broadly worded and requires significant judicial interpretation to effect its policy of promoting fair competition. The *Microsoft* case was one of the first instances in which a federal court was asked to apply the Sherman Act’s prohibitions to the computer technology industry. As Tencent did in *Qihu*, Microsoft urged the D.C. Circuit sitting as a full court (en banc) to alter the antitrust analysis applied in traditional sectors to reflect the unique market realities of information technology. The court ultimately declined to modify its approach, and it affirmed the previous three-judge panel’s ruling that Microsoft had violated the Sherman Act. Though *Microsoft* dealt with an earlier generation of computer technology, it addressed in substance the same legal issues as *Qihu*. The D.C. Circuit’s approach to the two questions at the center of *Qihu*—how to define the “relevant market” in the internet sector and how to assess “market dominance” or “monopoly”—are instructive of how a suit similar to *Qihu* might be resolved in the United States today.

With respect to the first step in the antitrust analysis, defining the relevant market, an American court would likely approach the *Qihu* case as the SPC did. Traditionally, U.S. law defines the relevant market from the perspective of the consumer, using a version of the HMT. Courts attempt to identify the market that contains all of the products that are adequate substitutes for each other



within a specific geographic area. A producer with a dominant position in this market could behave monopolistically (either by raising prices or lowering quality) and still earn a profit because consumers cannot punish the producer by moving their business elsewhere in the market. In the *Microsoft* case, Microsoft urged (as defendants

In both Microsoft and Qihu, the defendants argued that traditional notions of market dominance did not apply with the same force in the information technology context.

usually do) a broad definition of the relevant market which would have included all operating systems for personal computers as well as for mobile handheld devices in the United States. The D.C. Circuit rejected this proposal. It refused to include handheld devices in the relevant market because their functionality was much more limited than personal computers (particularly in the late 1990s), and they therefore were not adequate substitutes for Windows-operated PCs. It refused to include other operating systems (specifically, Apple's Mac OS) because it found that the cost barriers to consumers and the inconvenience of needing to learn new software meant that Mac OS was also not an adequate substitute for Windows.⁵ The court defined the market more restrictively: it limited it to operating systems for Intel-powered PCs.

Like the *Microsoft* court, the SPC in *Qihu* took the product that provided the alleged monopoly leverage (an IM service) and defined the relevant market as all products for which that product could be substituted. Because of the breadth of the computer technology industry, the relevant geographic market was defined broadly to encompass mainland China. As the SPC noted, the web application economy adds a new aspect to the

market analysis because many of its products are free to consumers, with revenue coming from third-party advertisers. As a result, hypothetical increases in price are not a useful tool of analysis. Instead, the SPC applied the HMT by considering a hypothetical decrease in quality. If a free web-based application were to experience a sudden,

consumer-unfriendly decrease in quality (for example, by losing functionality unless the user downloaded other, unrelated software from

which the monopolist could earn additional profit), what is the universe of products to which the user could turn for a replacement? Tencent contended that the relevant market should include all web-based applications (including, for example, email, gaming, and search engines). Like the *Microsoft* court, the SPC rejected the defendant's argument for such an expansive market definition. It reasoned that most web platforms are not adequate substitutes for QQ—people do not use an IM service to research historical information, nor do they use a search engine to communicate with friends. It concluded instead that the appropriate market was that for web-based messenger services in China. This reasoning closely resembles that employed by American courts, and a federal court in the United States would likely have come to the same conclusion.

The question at the second stage of the inquiry, how to define “market dominance” or “monopoly”, however, is somewhat more difficult. In both *Microsoft* and *Qihu*, the defendants argued that traditional notions of market dominance did not apply with the same force in the information technology context. Historically, courts in the United States have used market share as the main proxy for market power.⁶ But the defendants in



both cases argued that market share is misleading in the computer context because technology markets are more “dynamic” than other markets. They claimed that new and innovative technology in a particular field will quickly do away with most of its competition and create something like a monopoly. But given the relatively low barriers to entry, other firms will constantly be working to develop the next generation of technology and thereby capture a dominant share of the market for themselves in the near-term future. Because technology often benefits from “network effects” (the technology is more useful to consumers when a larger portion of the population uses it—part of Facebook’s or Twitter’s appeal to a consumer is that everyone else is on it), in many areas a market naturally organizes itself as a series of temporary monopolies rather than as one that sustains multiple large competitors for an extended period. Competition is sequential rather than simultaneous. Facebook occupies the social networking field until it is supplanted by a better network, which will in turn capture an overwhelming majority of users, or so the argument goes.⁷

The *Microsoft* court’s decision acknowledged that “predominant market share does not by itself indicate monopoly power”,⁸ but it stopped short of accepting that markets are fundamentally different in the technology sector. The D.C. Circuit found that Windows’ huge, 95% share of the PC operating system market, combined with relatively high barriers to entry, weighed in favor of finding that it had a monopoly. It expressed little interest in altering the market power analysis. The *Qihu* court seemed more receptive to Tencent’s argument that technology markets are “dynamic”, but it too declined to announce a bright-line rule to this

effect. In both *Microsoft* and *Qihu*, to assess the importance of the defendant’s market share, the courts looked to the practical realities of the market and, in particular, to the barriers to entry that potential competitors face. The SPC ultimately concluded that Tencent’s 80% market share was not “dominant” in the instant messaging field,⁹ because the barriers to entry were low enough to allow for newer firms to quickly capture a significant portion of those users. It is unclear whether an American court would adopt a similar analysis. While market share is never the only factor in a monopoly analysis, it is usually the starting point and a significant factor overall.¹⁰ But the *Microsoft* decision of sixteen years ago analyzed a market for operating systems in which barriers to entry (in particular, the fact that nearly every existing software program for PCs had already been programmed to Windows specifications, making it nearly impossible for a new operating system to offer the same user functionality) remained significant.¹¹ If a court in the United States today were faced with convincing evidence demonstrating that limits on competition in a particular field were minimal and that today’s monopolist could easily become tomorrow’s afterthought, it is possible that it would adjust its market dominance analysis accordingly.



THE CONCLUSION

Guiding Case No. 78 addresses emerging questions in antitrust law that are likely to become more common in the United States and other jurisdictions. In particular, technology firms accused of antitrust violations are likely to continue to assert the types of defenses advanced by Tencent. As internet businesses become more profitable and sophisticated, judges will be required to confront technology-based challenges to traditional antitrust doctrine, in particular those related to the pace of technological change. How relevant markets and market power are defined in global markets characterized by free products and low barriers to entry remain open questions. The SPC's sophisticated approach to these questions will serve as a useful resource to jurists not just in China but elsewhere in coming years.

Endnotes

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¹ 《北京奇虎科技有限公司诉腾讯科技（深圳）有限公司、深圳市腾讯计算机系统有限公司滥用市场支配地位纠纷案》 (*Beijing Qihu Technology Co., Ltd. v. Tencent Technology (Shenzhen) Company Limited and Shenzhen Tencent Computer Systems Company Limited, A Dispute over Abusing Dominant Market Positions*), STANFORD LAW SCHOOL CHINA GUIDING CASES PROJECT, English Guiding Case (EGC78), Apr. 7, 2017 Edition, <http://cgc.law.stanford.edu/guiding-cases/guiding-case-78>.

² 《中华人民共和国反垄断法》 (*Anti-Monopoly Law of the People's Republic of China*), passed and issued on Aug. 30, 2007, effective as of Aug. 1, 2008, http://www.gov.cn/flfg/2007-08/30/content_732591.htm.

³ See Corp. Counsel's Antitrust Deskbook § 22:1 (2017) (noting that federal antitrust agencies, such as the Federal Trade Commission and the Department of Justice, "have not released any official guidelines on the application of antitrust law to e-commerce, nor do there appear to be any immediate plans to do so. In speeches and at seminars throughout the country, officials of the agency have stressed one extremely important rule of thumb: when it comes to the application of the antitrust laws to Internet and e-commerce issues, the factual patterns may be different but the normal rules of antitrust analysis apply. It is clear that no new antitrust rules or standards will be formulated to deal with the problems raised by the Internet and e-commerce. Rather, the agencies will use existing antitrust standards of analysis").

⁴ *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (en banc), <https://www.ravellaw.com/opinions/918f34c19d957b1077ed99f89c74e1be>.

⁵ Microsoft also argued that "middleware"—that is, software that helps translate the code of a specific computer program into functions on the computer itself—should be the relevant market. The court rejected this argument on the ground that middleware technology was not yet capable of fully supplanting computer operating systems and likely would not be for the foreseeable future. See 253 F.3d at 53.

⁶ See *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 424 (2d Cir. 1945) (Learned Hand, J.), <https://www.ravellaw.com/opinions/6b6cdc88798ae0555f7b512719aef804> (stating that 90% market share "is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three per cent is not."); see also *Am. Tobacco Co. v. United States*, 328 U.S. 781, 813–14 (1946), <https://www.ravellaw.com/opinions/cce81b24861ffac893bb54615487026b> (adopting Judge Hand's emphasis on the importance of market share as persuasive).



⁷ See, e.g., J. Gregory Sidlak & David J. Teece, *Dynamic Competition in Antitrust Law*, 4 J. COMPETITION L. & ECON. 581 (2009) (speculating as to “[h]ow [...] competition policy [would] be shaped if it were to explicitly favor [...] dynamic [] competition over neoclassical (static) competition”).

⁸ 253 F.3d at 54.

⁹ See 《奇虎公司与腾讯公司垄断纠纷上诉案判决书》 (*Qihu Company and Tencent Company, The Appellate Judgment of a Monopoly Dispute*) (2013) 民三终字第4号民事判决 ((2013) Min San Zhong Zi No. 4 Civil Judgment), rendered by the Supreme People’s Court on Oct. 8, 2014, full text available on the Stanford Law School China Guiding Cases Project’s website, at <http://cgc.law.stanford.edu/judgments/spc-2013-min-san-zhong-zi-4-civil-judgment>.

¹⁰ See U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT: CHAPTER 2 (updated Jun. 25, 2015), https://www.justice.gov/atr/competition-and-monopoly-single-firm-conduct-under-section-2-sherman-act-chapter-2#N_20_ (“In determining whether a competitor possesses monopoly power in a relevant market, courts typically begin by looking at the firm’s market share [...]. Modern decisions consistently hold, however, that proof of monopoly power requires more than a dominant market share.”).

¹¹ 253 F.3d at 55.

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