

# Qihoo 360 v Tencent: First Antitrust Decision by The Supreme Court

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On October 16, 2014, the Supreme People Court (hereinafter “the Supreme Court”) of the People’s Republic of China issued the decision on the dispute between Qihoo 360 and Tencent.<sup>1</sup> It is the first antitrust case decided by the Supreme Court in China and ends one of the most significant antitrust cases brought under the Anti-Monopoly Law (“AML”).

The Supreme Court dismissed Qihoo 360’s claims on exclusionary practices and anticompetitive bundling against Tencent and upheld the decision made by the court of first instance, the Guangdong High People’s Court (Guangdong High Court). In the decision, the Supreme Court carried out a sophisticated antitrust analysis. It re-examined major issues such as market definition, market power and whether Tencent had abused its market power. The decision emphasized the importance of competitive constraints and dynamic competition. It also took into account the characteristics of multi-sided platforms (i.e. two-sided markets) in the assessment of market power.

It is a landmark decision for China and will likely influence how the Chinese courts approach these issues generally and for Internet industries particularly. It is also a significant decision by international standards. Released three days after the Nobel Prize was awarded to a French professor Jean Tirole of Toulouse School of Economics,<sup>2</sup> in part for his work on two-sided markets, it is one of the first decisions to consider the role of multi-sided platforms in antitrust analysis. It is also one of the most detailed antitrust analyses of competition in modern Internet businesses.

In this article, we will summarize the Supreme Court’s approach to assess the issues of market definition, market power and abuse of dominance.

The Internet industry in China expanded rapidly beginning in the late 1990s. Overtime, many thousands of companies entered the Internet-based business. By the end of December 2013, the number of Internet users had increased to 618 million and 45.8 percent of the population. Mobile Internet users had reached 500 million by the end of December 2013, up 80 million from the end of 2012.<sup>3</sup>

The case involved a dispute between two Internet companies in China. Tencent attracts users by providing a variety of free services including QQ (its IM platform), Weibo (its

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<sup>1</sup> See the Supreme People Court of P.R. China Civil Judgment No. Minsanzhongzi 4/2013. The Chinese version is available at [http://www.court.gov.cn/xwzx/yw/201410/t20141016\\_198470.htm](http://www.court.gov.cn/xwzx/yw/201410/t20141016_198470.htm).

<sup>2</sup> See Scientific Background on the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2014, “Jean Tirole: Market Power and Regulation,” October 13, 2014, available at [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/2014/advanced-economicsciences2014.pdf](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2014/advanced-economicsciences2014.pdf).

<sup>3</sup> China Internet Network Information Center (CNNIC), Statistical Survey Report on the Internet Development in China, January 2014.

micro-blogging platform), online gaming, online security, SNS, search and e-commerce. The company makes money from selling virtual products/items for its online gaming services; charging its users for SMS packages, mobile games, and other mobile value-added services such as mobile books and mobile games; and selling advertising to companies that want to reach Tencent's users.<sup>4</sup>

Qihoo360 attracts users by providing a variety of free services including online and mobile security through anti-virus software, a web browser, a game platform with games developed by third-party game developers, and a search engine.<sup>5</sup> Qihoo 360's Safety Guard, which is an Internet security product, had 456 million monthly active users in April 2013.<sup>6</sup> Qihoo 360 profits through selling advertising, and providing web game services.

On November 3, 2010, Tencent required the users of its IM services to choose between Tencent's QQ or Qihoo 360 software. Tencent's users therefore had to use security software made by providers other than Qihoo 360, including Tencent's own security software. Tencent and Qihoo 360 both restored interoperation on November 4, 2010, the next day. This is the famous "choose-one-from-the-two" incident, also known as "non-interoperability" conduct.

The case was initially heard at the Guangdong High Court. The Guangdong High Court dismissed Qihoo 360's allegations in March 2013. Qihoo 360 appealed to the Supreme Court.

The Supreme Court carried out in-depth analysis of the dispute and focused on five major issues. We will just discuss the first three, which applied economic analysis: market definition, market power and abuse of dominance.

### **Market definition**

The Supreme Court acknowledged that it is not necessary to define a clear relevant market in every abuse of dominance case. It would focus more on the market power and the anti-competitive impact of the alleged conduct than market definition itself. As market definition is "just a tool to evaluate the undertaking's market power and the competitive impact of alleged monopolistic conducts but not the goal,"<sup>7</sup> as the Supreme Court stated, it confirmed that the court of first instance, Guangdong High Court, just analyzed the possibility of market boundary, but did not give a clear conclusion on the boundary of the relevant market.

When defining the relevant market, the Supreme Court acknowledged the general application of the SSNIP test (also known as the "Hypothetical Monopoly Test"—HMT) as a

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<sup>4</sup>See Tencent 2011 annual report, p. 107.

<sup>5</sup> See Qihoo's Prospectus 2011. See also Paul Mozur, "Qihoo 360's Zhou Hongyi: Taking Aim at China's Internet," Wall Street Journal, November 30, 2012, available at <http://online.wsj.com/article/SB10001424052970204707104578094460340552442.html>.

<sup>6</sup> Qihoo 360 2012 annual report, p. 27.

<sup>7</sup> See *supra* note 1.

method of analysis. The Supreme Court, however, realized the application of the traditional SSNIP test to internet-based instant messaging (IM) services that features a “free” business model is limited. Instead, the Supreme Court relied on product characteristics to assess demand and supply substitution. They analyzed the substitution relationship between IM and Weibo, SNS, mobile text messaging and email. The court defined the relevant market as the IM service market in mainland China.

In particular, the Supreme Court highlighted the importance of dynamic competition when assessing the competition in Internet market:

“The Court finds that competition, especially internet competition, has dynamic characteristics. When defining relevant market, one should take into account of predictable and possible market reaction and changes in the future, in order to correctly decide whether there is any competitive constraint coming from other undertakings.”<sup>8</sup>

Compared to the decision of the court of first instance, the Supreme Court excluded Weibo and SNS from the relevant market. It, however, supported the analysis method of the court of first instance which emphasized the importance of dynamic competition instead of just focusing on the static competition.

“In this case, the court of first instance takes into account of the current growth and future trend of Weibo and SNS when analyzing whether Weibo and SNS belong to the relevant product market. Such a way of reasoning isn’t improper.”<sup>9</sup>

Meanwhile, the Supreme Court acknowledged competition of Internet platforms and emphasized the assessment of competition should focus on the user’s side. It would consider platform competition more in the assessment of market position and market power than in market definition.

## **Market power**

The significance of the Supreme Court’s decision in this case is to not simply rely on market share to assess whether Tencent has market dominant position. Given the defined relevant market, Tencent’s shares all exceed 80 percent in both the PC and mobile IM market, which is also the main allegation of Qihoo 360. High market share does not necessarily mean market power, as Tencent claimed, which has been upheld by the Supreme Court. The Supreme Court moved further to evaluate other important factors.

First, the Supreme Court took into account the current competition in the IM market in mainland China. It found that “competition in such a relevant market is quite sufficient.”<sup>10</sup> Evidence shows that at the time when the alleged conduct took place, there were over

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<sup>8</sup> See *supra* note 1.

<sup>9</sup> See *supra* note 1.

<sup>10</sup> See *supra* note 1.

dozens of IMs on the market. These IM products and services have gotten more and more reliable and mature over time with a significant user base. Especially with the development of mobile communication, new mobile IM providers continuously enter into the market. The Supreme Court focused on the major characteristics of competition in IM market: innovation competition, dynamic competition and platform competition.

Second, the Supreme Court cared more about whether Tencent had the ability to control product price, quantity or other trading conditions. The court found that given the “free” nature of the IM market, users have no willingness to pay. Tencent therefore has no ability to control prices on users’ side, let alone to decrease quality or control product quantity and other trading conditions.

The Supreme Court also analyzed financial power and technology conditions of Tencent, reliance of other undertakings on Tencent’s QQ instant messaging software, and market entry. In particular, the Supreme Court emphasized the importance of market entry in assessing market power.

“When assessing whether there is market dominant position, it’s important to evaluate the easiness of market entry and expansion of market share. Low market share doesn’t necessarily mean weak market competitive constraint. If undertakings could quickly enter into the market and effectively expand market, they will provide effective competitive constraints to the incumbent.”<sup>11</sup>

Based on the evidence, the Supreme Court found market entry in IM market to be relatively easy. It especially analyzed the “Choose One from The Two” incident. The court found: “The appellee’s “Choose-One-from-The-Two” conduct only lasted for one day. Such an incident caused Tencent’s competitor MSN’s users increase 23 million in the same month. Several competitors competed on IM market. This evidence strongly proves that Tencent doesn’t have significant market dominant position.”<sup>12</sup>

Therefore, the Supreme Court concluded that current evidence doesn’t support the claim that Tencent possesses market dominant position.

### **Abuse of market power**

When assessing whether Tencent had abused market dominant position, the Supreme Court has weighed both negative and positive effects that such alleged conducts have brought to consumers and competition. It highlighted that “the focus of the AML is not an individual undertaking’s interests, but whether the healthy market competition mechanism has been distorted or destroyed.”<sup>13</sup>

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<sup>11</sup> See *supra* note 1.

<sup>12</sup> See *supra* note 1.

<sup>13</sup> See *supra* note 1.

The Court analyzed Tencent's two kinds of conducts that were alleged anti-competitive by Qihoo 360: (1) "choose-one-from-the-two" incident; (2) bundling of IM and security software.

Regarding (1), after detailed analysis, the Supreme Court found that Tencent had no significant incentive to take such "non-interoperability" conduct to exclude and restrict competition in the IM market. In addition, the court found that such a non-interoperability conduct actually brought vibrant competition to the IM service market although it only lasted for one day. The court also analyzed the impact of such a conduct on the security software market and found the impact was actually quite little. Such a result not only proved that Tencent's non-interoperability conduct was not abuse of dominance, but also proved that Tencent doesn't have a dominant position.

Regarding (2), the Supreme Court did not find reliable evidence to support the Qihoo 360's allegation that such bundling behavior leverages Tencent's leading position in the IM market into security software market. Meanwhile, the court found there were legitimate reasons for Tencent to bundle QQ IM with QQ Software Manager since such a bundle provided function integration and improvements to quality and security, which consequently promotes IM's features and value.

Therefore, the Supreme Court concluded that neither non-interoperability nor bundling conducts violates the AML.

As the first antitrust decision made by the Supreme Court, the Qihoo v. Tencent decision will have a significant influence in China's antitrust enforcement.

First, it sets up the standard for antitrust private litigation with detailed antitrust analysis of market definition in general, and in abuse of dominance cases in particular. Especially it lays out the road map for a proper and rigorous antitrust analysis in assessing market power and abuse of dominance issues.

Second, it demonstrates that the Chinese courts, barely six years after the AML went into effect, are already adept at rendering sophisticated antitrust opinions and applying modern economic concepts. It suggests that economic analysis, and economists, have played a significant role in private antitrust litigation in China as they have in US private antitrust litigation and in cases brought by the European Commission. Qihoo and Tencent both retained economists and introduced economic evidence before the Supreme Court.

Finally, it is one of the world's leading and most sophisticated antitrust decisions concerning competition in Internet-based industries. It contributes to a better understanding of the competition issues in such fast-growing industries by considering the role of dynamic competition and multi-sided platforms.