Relevant Market Definition and Market Dominance Identification

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I. INTRODUCTION

The appellate dispute between Qihoo 360 Technology Co. Ltd. (“Qihoo”) and Tencent Holdings Limited (“Tencent”) regarding Tencent’s alleged abuse of market dominance was the first antitrust case ever tried by the China Supreme People’s Court (“CSPC”) and was also the longest-ever hearing held by CSPC so far, lasting for over 28 hours. CSPC issued a 113-page, 74,000-character, “textbook-like” ruling (“3Q War final ruling”). In this judgment, CSPC made a pithy exposition on relevant market definition, market dominance identification, and the relationship between the two. As the attorneys representing Tencent in the appeal and in the hearing, we would like to, incorporating both domestic and overseas relevant findings, provide an elaboration and necessary summarization of the following issues referred to in this ruling: the allocation of evidence adducing burden in relevant market definition, the role of “Hypothetical Monopolist Test” (“HMT”) in relevant market definition, the “Most and Important Rule” necessarily applied in Substitution Analysis, and the accurate view on the role of market share in finding market dominance from a dynamic competition perspective.

II. RELEVANT MARKET DEFINITION ISSUES

A. Finding Abuse of Market Dominance Solely Based on Direct Evidence without a Clear Delineation of Relevant Market Only Applies in Exceptional Situations, Which Shall Not Be Regarded as Universal

In accordance with Article 2 of the “Guidelines on Relevant Market Definition” (“Guidelines”) issued by the Anti-Monopoly Committee of State Council, relevant market definition is generally the starting point to analyze competition activities, and is an important step in antitrust enforcement. In abuse of dominance cases,
relevant market definition is generally considered as the beginning and the prerequisite of finding whether a business operator holds a dominant position in the relevant market and whether its conducts constitute abuse of market dominance. In “3Q War final ruling,” CSPC raised a pivotal point on defining relevant market as:

In the trials of abuse of market dominance cases, defining relevant market is the tool to evaluate the business operator’s market power and the impact cast by the alleged monopolistic conducts to competition, however, defining the relevant market itself is not the goal. Even without a clear delineation of relevant market, a business operator’s market position and competitive effects of the accused conducts could be evaluated through direct evidence showing the precluding or hindering effects rendered to competition. Hence, not every abuse of market dominance case needs an explicitly and clearly defined relevant market.3

CSPC’s aforementioned holding in such a significant case, “the first Internet anti-monopoly case in China,” raised heated discussions on the necessity of relevant market definition in all sectors of society. As such, an accurate comprehension of relevant market definition in cases of market dominance will directly affect the fundamental litigation strategies and trial logic in future cases. As scholar Mr. Liu Xu pointed out in his article posted after the first trial:

In face of the disputes on relevant market definition, relevant experiences from German and the European Union could be taken as reference, i.e. in the relevant market where instant messaging software QQ belongs to, Tencent’s market dominance can be assessed and concluded through the structural characteristics of the business operator and the suspected conducts exercised irrespective of competitive constraints.4

Furthermore, the “Unilateral Effects Theory” that emerged in 1980s in the United States also raised certain doubts on the function of market definition. “Unilateral Effect Theory” believes that a merger between firms selling differentiated products may enable the merged firm to profitably raise the price above competitive level without losing clients. Thus, as long as the merged entity has diminished market competition through its unilateral conducts, it could be concluded against the merger without defining the market.5

Back to “3Q War final ruling” itself, CSPC discussed relevant market definition issues under the first specific issue on “whether the first trial court’s omission to define a definite market constitutes failure in finding basic facts” in the first focus of dispute “how to define the relevant market in this case.” The CSPC’s basic perspective of analysis rests on whether the people’s court is obligated to explicitly and precisely define the relevant market during the trial in abuse of market dominance cases. Hence, CSPC’s conclusion that “not all cases of abuse of market dominance require an explicitly and precisely defined relevant market,” is addressing the people’s court ruling on abuse of dominance cases, not the plaintiff obligations.

CSPC’s above holding aims to clarify the responsibilities and role of people’s court in ruling on abuse of dominance cases, and thus held that first trial court’s omission to define a clear boundary of relevant product market did not amount to failure to achieve a clear basic facts finding. In the meantime, CSPC followed the traditional analytical approach of ruling on abuse of market dominance cases. That is, firstly it defined the relevant market in this case as the instant messaging service market in Mainland China; secondly based on this definition, CSPC analyzed whether Tencent held a dominant position in this market and whether its conducts constituted abuse of market dominance. As seen from the above, even if CSPC clearly pointed out the obscure nature of relevant market boundary in this case, it still strived to define the relevant market in this case. As such, CSPC is particularly prudent “to assess the accused business operator’s market position and the
potential market effects of the alleged monopolistic conducts based on direct evidence, demonstrating the effect of precluding or hindering competition.” Except for extremely special situations, market dominance shall not be directly found without defining relevant market.

B. Plaintiff Shall Bear the Burden of Proof to Define Relevant Market

CSPC has clearly pointed out in its “3Q War final ruling” that, “in abuse of market dominance cases, the party claiming others of abusing market dominance shall bear the burden of proof for defining the relevant market.” Pursuant to Article 8 of Provisions of the Supreme People’s Court on Several Issues Concerning the Application of Law in the Trial of Civil cases Arising from Monopolistic Conducts:

Where the monopolistic act sued falls under any of the acts of abusing market dominant position as prescribed under Paragraph 1 of Article 17 of the Anti-Monopoly Law (“AML”), the plaintiff shall bear the burden of proof to show that the defendant is dominant in the relevant market and has abused its market dominant position.

Thus, in abuse of market dominance cases, plaintiff assumes the burden to adduce evidence to define relevant market. Where plaintiff is intended to accuse others of abusing market dominance, it shall delineate the relevant market boundaries clearly. If plaintiff failed to perform an explicit and precise market definition, it may assume unfavorable results due to failure of adducing supporting evidence. As commonly known, relevant market definition is not an easy task, demanding massive evidence, fundamental data, industry reports and economic analysis, sometimes even large scale investigations. Doubtlessly, this process is extremely time and effort demanding. Should the burden of proof for relevant market be assigned to people’s court, it is not only groundless in law, but it is also inefficient and unreasonable. Imagine, if a plaintiff is allowed to launch an abuse of market dominance lawsuit with an arbitrarily defined relevant market or even a probable or vague relevant market definition, and shifts the burden of prudently defining relevant market to the people’s court, it will undoubtedly waste judicial resources, and may also lead to random or wanton attacks launched by entities against their competitors wielding such abuse of market dominance lawsuits. As such, the healthy market competition will be harmed deeply.

Though U.S. academics has been gradually questioning the functions of relevant market definition, the courts still hold on to the plaintiff’s responsibility of defining a relevant market in “monopolization” or “attempted monopolization” cases, and would reject a case that fails to define relevant market correctly. For instance, in Carl E. Person v. Google Inc., the U.S. District Court for the Northern District of California, San Jose Division (“San Jose Division Court”) took the view that “in order to make out a claim for attempted monopolization or monopolization, a plaintiff must define the relevant market”[7] the ‘search advertising market’ thus is too narrow to constitute a relevant market.” Hence, San Jose Division Court dismissed the monopolization and attempted monopolization claims presented in the first amended complaint. In appeal, the U.S. Court of Appeals for the Ninth Circuit affirmed and agreed with San Jose Division Court’s opinions.

C. The Basic Approach for Defining Relevant Market is Still Substitution Analysis, and HMT Shall Be Regarded as Necessarily Complementary

CSPC has clearly held in “3Q War final ruling” that, “as an analytical approach for defining relevant market, HMT is universally applicable.” This holding has led to divided understandings among antitrust practitioners and scholars. We take the view that, under the Guidelines and the practical application of HMT
by CSPC in “3Q War final ruling,” HMT as a relevant market definition method, does not have universal applicability. It shall only be applied when “the market scope of business operators is unclear or hard to ascertain.” CSPC’s holding of the universal applicability of HMT mainly refers to its analytical function, which could be applied to the complimentary side of a two-sided Internet market as well. The differentiation in market feature and competition factor would not hinder the application of HMT.

First, in accordance with Article 4 of Guidelines, “the definition of a relevant market shall mainly be based on the consumers' demand analysis. When competitive constraints on operators' acts resulting from supply-side substitution are similar to those resulting from demand-side substitution, supply-side substitution shall also be taken into account.” Article 7 of Guidelines, summarizing approaches to define relevant market, stipulates:

There is no exclusive method for defining a relevant market. In the antitrust law enforcement practice, different methods may to be used in accordance with the actual situation. In defining a relevant market, demand-side substitution analysis may be carried out according to factors such as product characteristics, intended use, pricing pattern, and supply-side substitution may be carried out if necessary. If the market scope within which operators compete with each other is vague or undefined, the relevant market may be defined on the basis of the analytical theory of "Hypothetical Monopolist Test" (see Article 10 hereof).

Article 10 further specifies “[t]he hypothetical monopolist test is an analytical theory for defining a relevant market. It can help resolve any uncertainty which is likely to occur in the definition of a relevant market.” Therefore, according to China’s current regulations on HMT, this method is not a general way or a main approach for market definition. HMT may only be used as an approach to resolve uncertainties in market definition when the relevant market boundary is unclear or hard to determine.

Second, substitution analysis should be consistently applied in relevant market definition, where the demand-side substitution should be the primary approach and supply-side substitution the complementary. Such view can be seconded by the Shanghai High People’s Court’s ruling of the vertical monopoly agreement disputes between Johnson & Johnson and Beijing Ruibang. Shanghai High People’s Court pointed out in its judgment that “HMT is a quantitative measurement based on the underlying principle of substitution analysis. Substitution analysis is still essential. If relevant market could be clearly defined by employing demand-side substitution and supply-side substitution analysis, there is no need to employ HMT anymore.” Notably, CPSC did not apply HMT formally in its 3Q War final ruling. CSPC referred to HMT only in its analysis of mobile text, email and geographic market. For instance, “if an instant messaging monopolist lowers the quality of instant messaging to a certain extent, it is unlikely for adequate users to switch to paid mobile text as substitute.” Thus, CSPC actually applied the demand-side substitution and supply-side substitution analysis as main approach to define relevant market. In case that substitution analysis could clearly delineate relevant market in the instant case, HMT is no longer needed.

D. Substitution Analysis Shall Hold on to “Majority and Important” Rule

Demand-side substitution analysis is the primary approach for defining relevant market. Most of the other methods are improvements or particularizations to demand substitution analysis. In defining relevant market, we shall first consider how to accurately comprehend and apply demand substitution analysis. In 3Q War antitrust suit, the involved instant messaging products simultaneously differentiated from and overlapped with Weibo, SNS, email, mobile text in respect of attributes and usage. To accurately apply demand-side
substitution analysis in order to achieve a clearly delineated relevant market boundary is not an easy task, which also constitute one of the focuses of disputes in the appeal. We take the view that CSPC established “majority and important rule” under demand-side substitution analysis in its application of demand-side substitution analysis to define relevant market, i.e. to analyze whether there are adequate users who would regard a specific good as alternative goods or regard a certain territory as alternative geography territory based on the core demand of majority users and from the perspective of the key attributes of goods.

1. Demand-side Substitution should be Analyzed on the Demand of the Majority of Users

As specified in the Guidelines, demand-side substitution determines the substitutability of different products from the perspective of consumers based on factors such as their needs regarding functionality and usage, recognition of quality, affordability of prices, difficulty in accessing the products, etc. In antitrust litigation and enforcement, to determine consumers and their scope would directly influence the boundaries of relevant market. Demand-side substitution analysis should start with the users of targeted products, i.e. users demanding the products subject to accused monopolistic conducts. As further clarified in CSPC’s 3Q War final ruling, relevant market definition should be based on the key characteristics and core functionality of the targeted products demanded by the majority of users.

In 3Q War final ruling, CSPC firstly started with the targeted products by pointing out that the Tencent QQ instant messaging (“IM”) service related to the accused monopolistic conduct is an integrated IM service, which is capable of proving three types of communication functions (text, audio, and video). In analyzing whether the non-integrated IM service should be included in the relevant product market in this case, CSPC underlined that text communication is the most frequently used function by 93.2 percent of users after comparing the integrated and the non-integrated IM service in respect of product characteristics, accessibility and functionality. Thus, text communication function is an important function favored by most users. As such, it concluded that non-integrated IM service is a close substitute of most integrated IM services. The relevant market definition in this case, was held to be Mainland China. Although tens of millions of users all over the world were affected by Tencent’s “choose one from two”, CSPC held most users demanding Tencent QQ were in mainland China. Hence, it inspected the relevant geographical market from the targeted Mainland China IM service market, and concluded the relevant geographical market of 3Q War antitrust case as the Mainland China market.

2. Relevant Product Analysis should be based on Most Users’ Preference and Options in respect to Product Characteristics and Functionality.

The substitutability of different products should be determined from the perspective of consumers; the majority users’ preferences and options towards product characteristics and functionalities should be concerned when comparing product characteristics, accessibility, functionality, etc., in order to determine whether the majority of users regard a certain product as a close substitute to the targeted product.

In the 3Q War final ruling, the CSPC, in addition to analyzing the text communication preference of most users in analyzing integrated and non-integrated IM service, also determined the issue of whether SNS and Weibo should be included as part of the relevant product market for this case. CSPC ultimately concluded, based on user statistics reports issued by China Internet Network Information Center (“CNNIC”) and iResearch Consultancy, that for the majority of users, IM service, SNS, and Weibo served different purposes. SNS and Weibo users were found to have a broader purpose, focusing more on social functions such as friend connection, information sharing, profile demonstration, and friendship development, etc.; SNS and
Weibo are more notable by their social nature. Therefore, from the perspective of the majority of users’ demands, the relationship between IM service and SNS or Weibo was held to be complementary rather than substitutive.

3. Product Characteristics and Pivotal Functions Are Key Criteria for Determining the Close Substitutability between Products

The attributes and functions of different products are not necessarily and completely different. The products included in the considerations to determine the scope of the relevant market must have some overlaps in respect of attributes, functions and usages. Hence, in assessing the substitutability between different products, the essential and pivotal attributes should be distinguished from the non-essentials and should be the focus of the analysis.

In 3Q War final ruling, CSPC recognized that though SNS and Weibo shared some common attributes with IM services, (e.g., Internet-based, online-notice of status, user profile management, free service, etc.) they still differ significantly in important attributes. When analyzing functions and purposes of SNS, Weibo and IM, the first instance court incorrectly overlooked the key difference between the former two groups of open communication, targeting mass users, and IM service’ focus on bilateral private communication or internal communication among small groups. Thus, the court overstated the social nature of IM service. In analyzing whether mobile text messaging, emails should be included in the relevant market definition, CSPC considered that “more importantly, IM service is free, while mobile text messaging is paid service”; “email differs in key functions and attributes with IM services, email does not have the instant nature of communication, neither does it have the function of notifying user online status, while the instant nature of communication is the most essential and most-focused function of IM service by users.”

In determining whether the relevant product market should be defined as Internet application platforms, CSPC gave an adequate consideration on the integrated nature of different Internet application platforms, i.e. almost all of them provide comprehensive Internet service and overlapped with each other to some extent. However, “the key issue is whether the mutual competition between Internet platforms on user attentions and advertisers have completely surpassed the boundaries decided by product or service attributes and imposed sufficiently strong competitive constraints on business operators.” CSPC pointed out “the competition between Internet platforms on user attentions and advertisers are based on the core products or services they provide.” The core products or services provided by these Internet platforms differs significantly in natures, characteristics, functions, usages, etc. These differences lead to the possible distinction in the main user groups and advertisers they may compete for, which ultimately determined the relatively big difference in business models, targeted user groups, subsequent market products, etc.

How to accurately apply demand-side substitution analysis is a key and complicated issue in antitrust enforcement and litigation. CSPC had an adequate application of demand substitution analysis in its 3Q War final ruling, and established an important analytical approach in demand-side substitution analysis— “most and important” rule. This rule focuses on the most users’ preferences and options on relevant products’ core functions, and grounds on the core and pivotal attributes of products to analyze the substitutability between different products. This rule will undoubtedly have an important and far-reaching impact on future antitrust practices.
III. IN INTERNET DOMAIN, A BUSINESS OPERATOR’S MARKET DOMINANT POSITION SHALL NOT BE DECIDED SOLELY BASED ON ITS MARKET SHARE IN RELEVANT MARKET

In the traditional cost-price oriented competitive market, a business operator’s dominant power and position in the relevant market can be reflected through quantitative and visual market share data, and this kind of quantitative market power data provides important guidance to determine whether this business operator possesses a market dominant position. However, market share is only a preliminary standard, if at all, but not a decisive standard in market dominance evaluation. As the case may be, several other specific elements shall also be taken into consideration. For example, stability of a certain market share in the relevant market, a comparison between business operators’ market shares in the same relevant market, the business operator’s pricing behavior, the intellectual advantage, the diversity of the relevant products, etc. In particular, attention shall be paid to the peculiarities and situations of competition in the relevant market, and core competition factors for the business operators.

More generally, even if a business operator possesses a market share lower than the specific data stipulated by law, the possibility of holding a market dominant position in the relevant market cannot be simply excluded. As stated by Mr. Lars-Hendrik Röller from the European Commission, Directorate General for Competition, in “China Antitrust Law Seminar” in 2005:

According to European Union laws and judicial precedent, if a business operator possesses 50 percent or more market share in relevant market, market dominance will be presumed. However, based on our current law enforcement practices, for some specific cases, a business operator possessing less than 50 percent market share in relevant market can still be found holding market dominance. Therefore, when we were having internal discussion of the trends of policies, for market dominance evaluation, we believe that we would lay less stress on market share in future.¹⁵

On the other hand, if a business operator possesses a market share that is higher than the threshold stipulated by law, it would not necessarily be found as having market dominance, and analysis should be made on a case-by-case basis. As mentioned by Mr. Makan Delrahim from the U.S. Department of Justice in “China Antitrust Law Seminar” in 2005:

In market power evaluation, if a business operator’s possession of market share reaches or surpasses 60 percent or 70 percent in relevant market, U.S. law executors would evaluate whether it holds market dominance. Nevertheless, even if a business operator has more than 70 percent market share in relevant market, market dominant power cannot be easily presumed, market situations shall also be carefully analyzed.¹⁶

In 3Q War antitrust lawsuit, Tencent’s alleged abuse of market dominance occurred in emerging Chinese Internet industry, in which the foundation Internet service is free. Therefore, Internet service providers compete with each other more on aspects like quality, service maintenance, and innovation, rather than price. CSPC pointed out in the 3Q War final ruling that,

The competition in Internet environment is highly dynamic, therefore the boundary of relevant market is far less clear than that of in traditional industry. Consequently, the indicative function of market share of a specific business operator shall not be overestimated, and more attention should be paid to the concrete facts and evidence demonstrating the difficulties of
entry barriers, the behaviors of business operators, and the impacts on market competition, that would be helpful for the evaluation of a business operator’s market dominance power in relevant market; in instant communication domain, business operators keep creatively competing with each other to provide better quality, services, user experience, and the innovation period for such products is relatively short.

Thus, in Internet industry, market share itself cannot accurately reflect the dominant power and position of a business operator in a competitive relevant market. Even though the CSPC concluded that for the market for both personal computer and cell phones instant messaging service, Tencent possessed more than 80 percent market share, the CSPC still ruled that Tencent did not possess market dominant position in the aforementioned markets. This decision was made after evaluating the difficulty for other business operators to enter in the relevant market, reviewing Tencent’s market behaviors, considering the competition constraints developed through Internet platform competition and in light of the highly dynamic and innovative characteristics of the Internet industry.

While studying European and American antitrust law enforcement practices, it is seen that even in the European Union, where the law enforcement standard is comparably stricter, the understanding of the European Commission and European courts regarding evaluation of market dominance in relevant market on the basis of market share of the business operator have been constantly evolving, and have been increasingly cautious. In 2011, as the European Commission pointed out in the opinion decision for the proposed Microsoft/Skype concentration,

"Market shares only provide a limited indication of competitive strength in the consumer communications services markets. Consumer communications services are a nascent and dynamic sector and market shares can change quickly within a short period of time...market shares are not the best proxy to evaluate the market power of providers of consumer communications services and they only give a preliminary indication of the competitive situation in these dynamic markets."

Accordingly, the European Commission believed that the concentration would not constrain competition even though, after Microsoft’s acquisition, the market share in the subdomain video call would exceed 80-90 percent. When the case was appealed, the General Court of the European Union stated in the judgment:

"The consumer communications sector is a recent and fast growing sector which is characterized by short innovation cycles in which large market shares may turn out to be ephemeral. In such a dynamic context, high market shares are not necessarily indicative of market power and, therefore, of lasting damage to competition which Regulation No 139/2004 seeks to prevent."

In some U.S. antitrust lawsuits targeting relevant Internet companies, it is observed that market dominance can be found solely based on market shares in the relevant market. In American Online v. GreatDeals.Net et al, the Judge of the U.S. District Court for the Eastern District of Virginia, Alexandria Division pointed out that, “to determine whether there is a high probability of success in monopolizing the market, courts often consider the relevant market and a participant's ability to lessen or destroy competition in that market.” In Emigra Group LLC v. Fragomen, Del Rey, Bernsen & Loewy, LLP, et al, the Judge of the U.S. District Court, S.D. New York stated that, “market power can persist only when entry barriers – market
circumstances, governments, or the defendants – block rivals’ entry or expansion. And the lack of significant entry barriers can defeat a monopolization claim, even in the fact of a defendant’s high market share.”

IV. EPILOGUE

In order to apply and improve Chinese Anti-Monopoly Law, in addition to efficient and effective investigations performed by enforcement agencies, the people’s court also needs to professionally and prudently administer the law and develop AML judicial practices. Only in this way can the development and improvement of Chinese AML be jointly promoted. In the 3Q War final ruling, CSPC expressed its opinions on identifying the relevant market and evaluating market dominance, specifically for the Internet industry. This 3Q War final ruling not only integrated experiences from Europe and America antitrust lawsuits, but it also fully considered and relied on Chinese development practice. Hence, CSPC rendered a proper ruling in accordance with Chinese antitrust enforcement practice. After this ruling, Chinese antitrust judicial litigation and enforcement investigation will be profoundly influenced.

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3 Qihoo 360 v. Tencent, Min San Zhong Zi No.4 (China Supreme People's Court. 2014).


6 See Qihoo 360 v. Tencent, supra note 3


8 Id. at 15-16.

9 Id. at 3.

10 See Qihoo 360 v. Tencent supra note 3 at 77.


12 See Qihoo 360 v. Tencent, supra note 3 at 88-89.

13 See Qihoo 360 v. Tencent, supra note 3 at 90.

14 Id.


16 Id. at 122 quoting speech given by Mr. Makan Delrahim of U.S. Department of Justice in “China Antitrust Law Seminar” in 2005, Beijing.
Commission Decision C(2011) 7279 declaring the concentration between undertakings involving the acquisition of Skype by Microsoft to be compatible with the internal market and the Agreement on the European Economic Area (EEA) (Case COMP/M.6281 – Microsoft/Skype)


T-79/12, Cisco Systems Inc. and Messagenet SpA v. European Commission, at 69, December 11, 2013, not yet reported.
