ANTITRUST ENFORCEMENT AND LITIGATION IN CHINA'S INTERNET INDUSTRY

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I. INTRODUCTION

After more than two decades of rapid development, China's internet industry boasts the largest number of netizens, and the most extensive broadband network in the world today. According to the China Internet Network Information Center, by the end of June 2019, the number of Chinese internet users had surpassed 854 million, and the internet penetration rate had reached 61.2 percent, a rise of 1.6 percent over the previous year. Chinese netizens are active in a variety of internet segments, such as instant messaging, social networking, online shopping, mobile payment, video and music streaming, mobile ride hailing, and online education.

While the explosive growth of China's internet industry has given birth to some of the world's largest internet companies, including Alibaba, Tencent and ByteDance, it has posed new challenges for China's legal and regulatory framework, particularly in terms of the antitrust laws and regulations. Adopted in 2008, the Anti-Monopoly Law of China ("AML") is in need of amendment not only to keep pace with new market dynamics, but also to safeguard and facilitate open and fair competition online.

II. THE ANTITRUST LAW FRAMEWORK FOR THE INTERNET INDUSTRY

Unlike in the automotive, pharmaceutical and intellectual property sectors, China's antitrust enforcers have not issued stand-alone regulations or guidelines specifically for the internet industry, probably due to the complexities in internet competition. Instead, China's antitrust enforcers have maintained that the basic framework of antitrust laws applies to the internet industry while acknowledging the special characteristics of internet competition by adding new, internet-specific rules to general regulations.

In its first move, the State Administration for Market Regulation ("SAMR"), China's top antitrust enforcer, adopted Interim Provisions on Prohibition of Abuse of Market Dominance, which went into effect on September 1, 2019, to address internet competition issues in three aspects.

First, in determining the market shares of undertakings, sales values, volumes, and "other indicators" may be considered. The head of the SAMR Anti-Monopoly Bureau clarified at a press conference on August 30, 2019 that the addition of "other indicators" is to make room for scientifically determining the market shares of internet companies. Indeed, industry practitioners have suggested multiple methods of market share calculation to reflect the dynamics of internet competition, such as the number of active users, time spent on applications, gross merchandise value, and platform fee revenues.

Second, factors in assessing the market dominance of an internet undertaking include competitive dynamics, business models, number of users, network effects, lock-in effects, technological features, market innovation, the ability to access and process relevant data, and each undertaking's market power in related markets. It should be noted that network effects, lock-in effects, data processing capacity, and leverage from related markets are factors specific to the internet sector and subject to ongoing debate among scholars and practitioners as to their true significance.

Third, dominant undertakings are prohibited from selling products and services below cost. Where the free-of-charge business model commonly seen in the internet economy is concerned, both free-of-charge and chargeable products and services must be taken into account to determine whether sales are truly below cost. This provision apparently recognizes the two-sidedness of platform economies, and attempts to allow for a comprehensive assessment of the impact of relevant business models.

In its second legislative move, the SAMR published a draft amendment to the AML on January 2, 2020 for public comment, which reiterated its stance on the assessment of the market dominance of internet companies. Article 21, paragraph 2 of the draft amendment provides that in determining the market dominance of internet undertakings, network effects, economies of scale, lock-in effects, and the ability to access and process relevant data must be considered. The proposed date for the adoption of the amended AML has not yet been determined.

III. CHINA'S ANTITRUST ENFORCEMENT IN THE INTERNET INDUSTRY

Although China's antitrust regulators are actively amending existing laws and regulations to keep pace with developments in the internet economy, how the new regulations should be interpreted and enforced in practice is yet to be tested. At a regulatory guidance symposium held on November 5, 2019, the deputy head of the SAMR Anti-Monopoly Bureau affirmed that the internet industry has been a priority on the antitrust agenda over the past few years, and that the SAMR has devoted ample resources to researching and analyzing the internet economy. However, the SAMR has yet to issue its first infringement decision in the internet sector. This is not because the internet is immune to abusive conduct. Rather, competition in the internet sector is allegedly fierce, and competition issues in this sector are particularly complicated and worthy of careful examination.

In the past, the SAMR has taken a prudent and inclusive approach towards internet competition, with a view to encouraging innovation in the "new economy." However, as the internet economy has grown, to the point that it now affects almost every aspect of daily life, calls for more stringent regulation are on the rise. The special "internet" provision in the draft AML amendment, as previously mentioned, has been interpreted as paving the way for increased enforcement in coming months or years.

A. Either-Or Arrangements

One particular behavior that has garnered much attention in China is the "either-or" tactics allegedly engaged in by certain internet platforms.

People increasingly place orders for almost everything through mobile apps. Over the past few years, there have been reports that some online platforms request partner merchants to sign exclusivity contracts that require merchants to commit all their business to one platform. This kind of arrangement has been termed the "either-or clause."

Whether this "either-or" tactic infringes antitrust rules has been subject to heated debate. Some argue that exclusivity requirements that are not reasonably necessary to achieve business objectives could hinder market entry by potential rivals and raise the operational cost of small competitors.

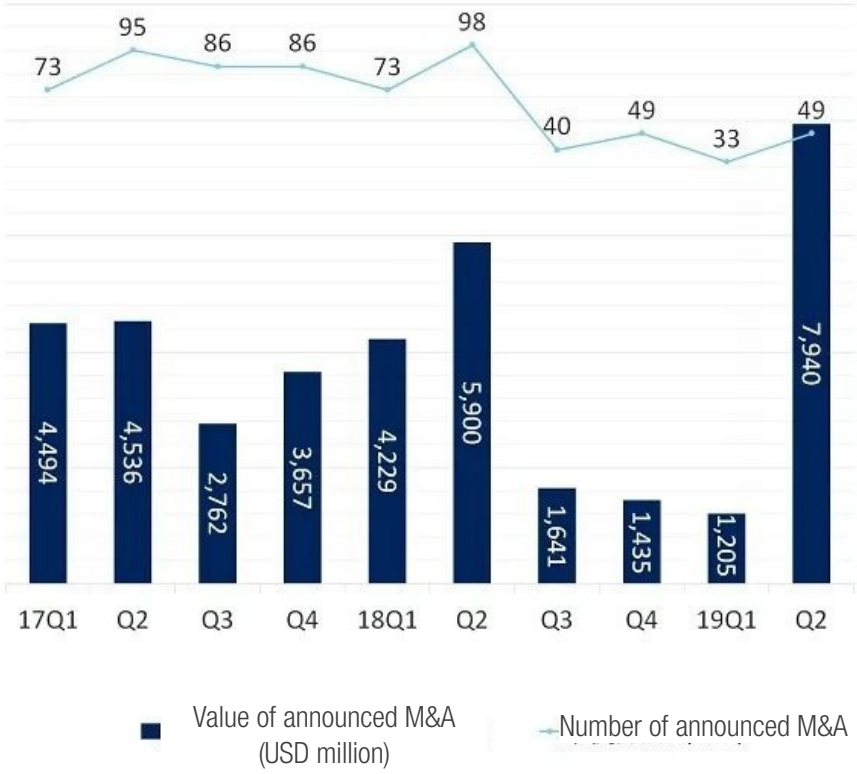
Other economists and lawyers point out that exclusivity arrangements could reduce transaction costs and eliminate free-riding problems, thus incentivizing relationship-specific investments. These benefits would be particularly significant where internet platforms do not have substantial market power. This camp of scholars and lawyers further contend that, online, where competition is dynamic and multi-homing is prevalent, platforms do not have as much market power as on traditional markets, because switching costs between different platforms are negligible, and innovative business models can disrupt the entire ecosystem in short order. Online, exclusive dealing is likely to be pro-competitive on balance, particularly when it is engaged in by companies without substantial market power.

At the above-mentioned regulatory guidance symposium, SAMR officials voiced their opinion that either-or clauses may be in violation of antitrust rules, and that the SAMR would examine conduct more closely, or open formal investigations where appropriate to safeguard the proper functioning of the internet economy. However, due to the complexity of business models in the real commercial world, some critical issues, such as whether a specific arrangement is in fact an "either-or clause," and whether it is pro- or anti- competitive under the rule of reason, are subject to specific assessment.

B. Merger Review in the Internet Sector

Although China is home to some of the world's largest internet companies, their M&A activities have not been subject to much review by the country's antitrust regulator. As the chart below shows, internet-related M&A activities have continued unabated over the past three years. It has thus puzzled many practitioners that internet companies have not appeared frequently in public merger control filings.

M&A Trends in the Internet Sector 2017 – 2019Q2



Source: CVSource

In August 2016, Didi Chuxing announced its acquisition of Uber China, and became the largest mobile ride-hailing company in the country. Shortly afterwards, the Ministry of Commerce ("MOFCOM") disclosed that it had launched an antitrust investigation into Didi's failure to make a pre-notification to MOFCOM – so-called "gun jumping." In November 2019, the SAMR confirmed at a press conference that the probe was still ongoing. However, the case has dragged into its fourth year without any progress being disclosed.

Various reasons have been cited for the lack of merger control review in the internet sector.

First, because internet activities are heavily regulated in China, investors have used the variable interest entity ("VIE") as a vehicle to bypass regulatory hurdles. There has been speculation that the SAMR and MOFCOM are reluctant to delve into VIE issues. As a result, whether mergers by VIE entities are subject to the jurisdiction of antitrust authorities remains uncertain.

Second, the appropriate method to calculate the turnover of internet companies is controversial. Some argue that sales generated by platform merchants should not be attributed to the platform's turnover. Instead, only the commission or service fees charged by the platform should be counted as the platform's revenue. Consequently, many internet companies would not be caught by the statutory turnover thresholds for an antitrust filing.

Third, whether a non-notified merger in the internet sector creates anticompetitive effects is subject to debate. For example, it is arguable whether ride-hailing apps compete with taxi companies, and thus whether they are in the same relevant market. Moreover, the question of how to assess the competitive dynamics of two-sided platforms adds a further level of complexity.

Fourth, even if a non-notified merger is found to have restricted competition, the question of how to remedy any such effects create another headache for enforcement officials. For a company like Didi, which is valued at as much as USD 56 billion, unwinding the transaction

would be unthinkable, but a statutory penalty of RMB 500,000 (approximately USD 70,000, the maximum fine under the current AML) is unlikely to have any deterrent effect.

To address these problems, it has been suggested that value of the merging parties be used as the notification threshold in lieu of revenues, and that penalties for non-notification be substantially raised. The draft AML amendment provides that the penalty for non-notification be raised to a maximum of 10 percent of a company's turnover in the preceding year, and that the SAMR be authorized to adjust the filing thresholds so that the agency can efficiently react to new developments. Antitrust observers will closely follow whether internet M&A will be subject to more stringent scrutiny by antitrust enforcers.

IV. CHINESE ANTITRUST LITIGATION IN THE INTERNET INDUSTRY

A. China's Reformed Jurisdiction System for Antitrust Litigation

Similar to other major jurisdictions, aside from public enforcement, in China there are also other means to obtain antitrust relief, namely private enforcement. In addition, if an injured party disagrees with an administrative decision, they may apply for "administrative reconsideration" or file an administrative lawsuit.

On January 1, 2019, the Regulations on Some Issues of the Intellectual Property Court ("IP Regulations") came into effect. China's civil antitrust jurisdiction ushered in a great transformation: the new structure of the IP court of the Supreme People's Court will hear appeals against first instance judgments of local IP courts and intermediate people's courts. The IP court of the Supreme People's Court will also directly hear appeals against administrative monopoly cases decided by local IP courts and intermediate people's courts at the first instance. Such appeals crossing the court hierarchy are known as "Leapfrog Appeals" in the Anglo-American legal system. In other words, an appeal of a first-instance judgement may, in some circumstances, bypass intermediate courts of appeal, and go directly to the Supreme Court.

Since the IP Regulations provide for jurisdictional allocation for antitrust litigation, China has formulated the following system:

1. The IP Court of the Supreme People's Court ("IPCSC") will be the appellate and retrial court for all antitrust cases of first instance in China.

2. The Beijing, Shanghai, and Guangzhou special IP Courts were set up in 2014, and exercise special jurisdiction over antitrust cases at first instance within their respective jurisdictions. The Guangzhou IP Court hears cases originating within the territory of the whole Guangdong Province, except Shenzhen. These three IP courts are intermediate courts. Before the establishment of the IPCSC, the first instance antitrust cases tried by the IP courts were appealed to the higher courts in Beijing, Shanghai and Guangdong Province. As of January 1, 2019, the first instance antitrust cases in the special IP courts are all appealed to the IPCSC.

3. The local special IP Tribunals in city intermediate courts – since January 2017, the Supreme People's Court has approved the establishment of 20 special IP Tribunals in Zhengzhou, Tianjin, Changsha, Xi'an, Hangzhou, Ningbo, Jinan, Qingdao, Fuzhou, Hefei, Shenzhen, Nanjing, Suzhou, Wuhan, Chengdu, Nanchang, Lanzhou, Changchun, Haikou, and Urumqi. These IP Tribunals are usually set up in intermediate courts in provincial capitals or major cities and are internal divisions of the local intermediate courts. At present, apart from Zhejiang, Shandong and Jiangsu Province, which have established two IP Tribunals to hear cases in different parts of the province, other provinces have only set up one IP Tribunal in their respective capital cities to handle cases across the province. As with IP Courts in Beijing, Shanghai and Guangzhou, appeals from first instance antitrust cases tried by the local special IP Tribunals will all be heard by the IPCSC.

4. Other civil tribunals in intermediate courts – other provincial capitals which do not have established the special IP Tribunals are still on the old track whereby the Third Civil Tribunal of the intermediate court in the relevant provincial capital usually hears antitrust cases from the province. However, it seems likely that more special IP courts and tribunals will be established in the near future.

B. Challenges in Antitrust Litigation Practice

After ten years of AML enforcement, the Supreme People's Court named ten "typical" antitrust cases in 2018. Over the past decade, since the implementation of the AML, the number of antitrust cases accepted and concluded by the people's courts has increased significantly. The Supreme People's Court has stated that by the end of 2017, 700 new cases had been accepted at first instance, and 630 were completed. These cases involve transportation, insurance, medicine, food, household appliances, power supply, information networks and other industries. Of these cases, the majority concerned alleged abuses of market dominance (which accounted for more than 90 percent of all cases), and monopoly agreement cases.

Nonetheless, despite the increased number of antitrust cases, plaintiffs' winning rates are still very low, and almost all cases are lost due to lack of evidence. In some specific cases, both parties often lack legal arguments, economic analysis and evidential support concerning relevant market definition and the establishment of dominance.

In addition, the rules governing coordination between antitrust investigations and litigation procedures are unclear. For instance, do parties still need to prove the facts that have been established in a decision of the enforcement agencies? If an agency decides to suspend or terminate an investigation based on an undertaking from the parties, can the existence of monopoly behavior be inferred? In cases that involve both litigation and administrative investigations, will relevant documents such as a voluntary surrender and application for leniency, as submitted by a party in the administrative procedure, be taken as evidence against that party in any subsequent litigation? All these questions need to be further addressed by legislators and judges.

C. Antitrust Litigation in the Internet Sector

In a report issued by the Supreme People's Court, it said that, in the past decade, the rate of antitrust litigation is generally increasing, and that the industries or fields involved are rather wide, covering transportation, insurance, medicine, food, household appliances, power supply, information networks and other areas. Especially, cases in the internet sector appear frequently. This trend is also the result of the explosive development of China's internet industry.

One milestone case in the internet industry is *Qihoo v. Tencent*. This case was also listed in the top 10 antitrust cases (2008-2018) by the Supreme People's Court. And the Supreme People's Court's judgment has had a demonstrable effect on proceedings in subsequent cases.

In its judgment, the Supreme People's Court pointed out that in litigation concerning abuse of market dominance, the definition of the relevant market is a tool for assessing the market power of the operators and the impact of the alleged behavior on competition. However, it is not an end in and of itself. Even if the relevant market is not clearly defined, the market position of the defendant and the potential impact of its behavior can be evaluated through direct evidence to the effect that it excludes or impedes competition. Therefore, not every case of abuse of market dominance needs a clearly defined relevant market.

Further, the Supreme People's Court held that a high market share is not dispositive of a dominant market position. Competition in the internet industry is highly dynamic, and the boundaries of the relevant market are far less clear than in traditional fields. In this case, the court will not overestimate the importance of market share data, but will instead undertake a comprehensive assessment based on multiple factors, as specified in Article 18 of the AML, to determine whether internet operators in fact hold a dominant market position.

In 2018, the Supreme People's Court extended the trial approach it took in the *Qihoo v. Tencent* to *Xu Shuqing v. Tencent*. The lawyer Xu Shuqing filed a lawsuit against Tencent for abuse of dominant market position in the Internet Emoji Service Market. The Supreme People's Court held that in determining the existence of a dominant market position by an internet enterprise, market shares only have a coarse-grained and potentially misleading use.

Notably, in the latest Revised Draft of the AML, released on January 2, 2020, Article 21 provides that, in determining whether internet operators have a dominant market position, factors such as network effects, economies of scale, lock-in effects, and the ability to control and to process related data must be considered. This article echoes judicial practice in the past and will provide a new legal basis for the court's approach.

As mentioned above, the internet industry is also facing the same challenges in antitrust litigation practice that traditional industries are. Without innovation in the rules of civil procedure and the AML, internet firms will still face difficulties collecting and providing evidence to win lawsuits. In the meantime, future judgements of the Supreme People's Court in different cases will fulfil the role of precedents, and will still need to be observed. In any event, economic analysis is going to be increasingly important as evidentiary support in terms of relevant market definition and the determination of market dominance. It can be predicted that parties to litigation and even courts themselves will frequently invite economists as expert witnesses or consultants in antitrust litigation in the internet sector.

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