

China issues record antitrust fine

SAMR sheds further light on its position towards the online sector

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Summary

On Saturday 10 April 2021, the State Administration for Market Regulation (SAMR) issued a landmark **decision**, penalising the Chinese e-commerce group Alibaba for abusing its dominant position. The Chinese authority imposed a record fine of RMB18.228 billion (USD2.8bn) on Alibaba for preventing merchants who sold their products on its online platform from dealing with other competing platforms (Decision).

The Decision is a turning point for antitrust enforcement in China: it marks SAMR's first major antitrust decision in recent years, and the highest fine that SAMR has ever imposed on any company. It signals SAMR's (and other Chinese authorities') increased scrutiny and recent drive to increase enforcement activity in the online sector. Setting aside the symbolic significance, SAMR has set a precedent for future enforcement actions in the online sector going forward.

Background

The Decision does not come as a surprise - although it was rendered less than four months after SAMR's official **investigation announcement** in December 2020.

The Decision follows China's intensive antitrust investigative campaign in the online sector in the past couple of months. An earlier signal that SAMR was stepping up its actions in the sector was in July 2020 when it cleared a transaction (*Mingcha Zhegang/Huansheng*) in the online sector involving Variable Interest Equity (more commonly known as "VIE") structures. VIE nominee ownership structures, which are commonly used in the sector, have rarely been notified for merger review in the past decade and therefore signalled the authority's largely hands-off approach to the sector. SAMR's shift in attitude towards VIE structures indicated a clear signal of shifting focus and tightened scrutiny towards the sector.

In November 2020, SAMR published draft antitrust guidelines on China's "platform economy", the final version of which was formally adopted, in record time, only three months later in February 2021 (the Platform Guidelines). This guidance marks the first time that SAMR has specifically recognised the description of and market importance of online platform participants in the digital economy. In addition to this, in December 2020 and March 2021 respectively, SAMR also issued 13 penalty decisions on several Chinese tech firms for failing to notify past transactions. In January 2021, China's central bank, the People's Bank of China, also released draft rules on the "non-bank payment industry" targeted at regulating e-payment platforms.

Following the adoption of the Decision on 10 April, SAMR (along with the Cyberspace Administration and Taxation Administration) summoned 34 Chinese internet companies on 13 April, and requested that they conduct “self-examination” into their business activities and make “comprehensive” rectifications. All 34 companies have publicly made the “compliant operation commitment” in batches, declaring their antitrust compliance commitments.

The key lessons from the Decision

In the Decision, SAMR found that Alibaba had abused its dominant position by imposing exclusive dealing obligations on merchants operating on its e-commerce platform. This case is not the first abuse of dominant position case in China (see for instance, *Qualcomm* in 2015 and *Tetra Pak* in 2016), but at least five lessons can be learned from the Decision:

Lesson 1: Relevant market definition confirmed

Defining a relevant market has always been a challenge for cases in the online sector – both in China and abroad. In the Decision, however, SAMR has taken a clear stance on the market definition.

In an earlier landmark court case in China (QQ/360, 2014), in order to assess whether the then nationwide popular instant messaging software QQ had a dominant position, the Supreme Court of China (SPC) carefully assessed which software, mobile applications, text message services and social media services should be included within the scope of the “instant messaging services market”. The SPC recognised in its judgment that the market definition should take into account the competitive and fast-evolving nature of the internet sector, underlining the challenge faced by antitrust authorities in defining the relevant market in the internet sector.

The draft version of the Platform Guidelines noted that in certain specific abuse of dominance cases, it is possible to find an infringement without defining the market (a position that was not conceded before in practice), although in the final version this reference was replaced by a more subtle statement that a market definition is “usually required”.

In the Decision, on the contrary, SAMR seems to have adopted a more affirmative attitude by explicitly defining the relevant product market as the “online retail platform services market” and specifically setting out the following key features of the market:

- i) Online retail platform services cannot be substituted with offline retail services;
- ii) The market for online retail platform services should not be further segmented:
 - a) by different business models (ie B2C and C2C are part of the same market);
 - b) by different sales methods (either through active search efforts by the customers themselves, or through active promotional efforts of the platform merchants to attract customers); or
 - c) by the categories of products sold on the online retail platforms - ie online retail platform services for all products form one single relevant market.

SAMR also took the view that the relevant geographic market of the online retail platform services market should be China instead of worldwide. As a general feature in the tech sector, online platforms and mobile applications are often considered as “borderless”. However, SAMR firmly concluded in the Decision that the geographic market should be China. This is aligned with the SPC’s position in QQ/360, where it disagreed with the first instance court’s position that the relevant geographic market for the instant messaging services market should be global: the SPC concluded that it should be limited to China. The geographic market

definition probably also reflects the fact that China, over the years, has developed its own unique online ecosystem.

Lesson 2: Establishing dominance: multiple factors to consider

Companies and practitioners often complain that antitrust authorities give too much weight to market shares when defining “dominance” and disregard other relevant economic factors. In the Decision, SAMR, however, did consider a number of different factors when establishing dominance.

According to the Decision, Alibaba had a market share of over 50%, and SAMR took into account the fact that this had been the case for five consecutive years (between 2015 and 2019). The authority also concluded that this was the case both based on “platform service income” and on “product trading value on the platforms”. The Decision did not explain further how the “platform service income” or “product trading value on the platforms” is calculated; the former seems to refer to the total income of the online platforms as a result of the fees charged by these platforms (service fees, commissions, etc.), whereas the latter seems to refer to the total amount paid by customers to the platform merchants. This implies that SAMR is open to analyse at least two alternative criteria for assessing the market shares of online retail platforms.

SAMR also disclosed the Herfindahl-Hirschman Index (HHI) and the four-firm concentration ratio (CR4) of the online retail platform services market in China between 2015 and 2019, pointing to a high market concentration during this period.

Further, SAMR added that Alibaba’s market power is also characterised by its ability to control the service fees, the network traffic within the online platform and the sales channels, the dependency of the users and platform merchants on Alibaba, as well as the various technical and financial obstacles for potential new entrants.

It also appears that SAMR took into account the fact that Alibaba holds a large amount of data, its algorithms, its cloud services offering, as well as its strength in artificial intelligence technologies when assessing its market power. SAMR also took into account the network effect and the lock-in effect as a result of the customer stickiness, as well as the high cost for platform merchants to switch to another competing platform.

Finally and importantly, SAMR did not only consider the core services provided by Alibaba on the online retail platforms, but also looked at Alibaba’s entire portfolio of businesses, including in logistic chains, payment services, as well as cloud computing services, and concluded that all of these activities further strengthened its market power in the online retail platform services market. This echoes the view in the Platform Guidelines, as well as the SPC’s earlier view in QQ/360, where SPC already took note of the “platforming” (“平台化”) trend of large tech firms in China, ie the use of platforms to reach customers for all aspects of their business and developing related services.¹

Lesson 3: Exclusivity by a dominant player is abusive

Alibaba operates China’s largest online retail platform Taobao and its flagship store Tmall. Merchants sell their products to consumers through its platform.

In its Decision, SAMR concluded that Alibaba has been abusing its dominance by forcing those merchants to only deal with Alibaba and not with any other competing online platforms (Alibaba’s policy was known as the “choose one from two” (“二选一”) policy). Specifically, Alibaba prohibited merchants from opening online

¹ Although, arguably, SPC did not eventually fully recognise the defendant’s statement that “competition in the online sector is essentially competition of platforms”, as it still focused its assessment on one single service offered by the defendant in the underlying case – the instant messaging services.

stores on other competing online platforms, and/or participating in the promotional activities of other competing online platforms.

SAMR found the existence of “exclusive dealing”, as referred to in Article 17 of the Anti-monopoly Law, on various grounds: exclusivity was imposed on the merchants by means of written agreements or oral warnings, together with multiple penalties for non-compliance such as: (i) a reduction in Alibaba’s support of the merchants in the platform’s promotional activities; (ii) disqualifying the merchants from participating in promotional activities; (iii) downgrading their product ranking in search results; and (iv) the cancellation of other benefits normally granted to the merchants on the platform. The authority concluded that all these measures significantly disrupted the business operations of the merchants and harmed their legitimate interest.

Lesson 4: Emphasis on innovation and openness

SAMR analysed the anti-competitive effect of the alleged exclusive dealing conduct from multiple angles, albeit briefly. Firstly, the Decision noted that Alibaba’s exclusivity requirement excluded and restricted (current and potential) competition in the market by undercutting other competing platforms. Secondly, it concluded that Alibaba’s exclusivity requirement clearly jeopardised the interest of the merchants on the platforms, and reduced intra-brand competition. Thirdly, it also ruled that Alibaba’s exclusivity requirement restricted innovation and diversity in the platform economy, while the very ideology of the platform economy is meant to be – according to SAMR – “open, inclusive and shared”. Lastly, Alibaba’s exclusive requirement also harmed customers’ freedom of choice and rights to fair trading. In the long term, SAMR concluded that Alibaba’s exclusivity requirement would compromise the “prospective interest” of customers, as well as the “overall social welfare standard” – although SAMR did not provide detailed explanation as to what it meant.

Lesson 5: SAMR is not shying away from imposing high fines

The fine was set at RMB18.228 billion, constituting 4% of Alibaba’s entire group revenue (including revenue generated from other non-retail platform business lines) in China in the calendar year 2019, clearly demonstrating that SAMR can and will impose significant fines in this area. Similar to many prior cases, SAMR did not use its power to further confiscate the “illegal gains” of the Alibaba group in addition to the fines. No explanation was, however, provided as to how the fine was calculated (in China, the final version of the guidelines on setting the antitrust fines, including in dominance cases, is still pending, although a draft version was published in 2016).

Concluding remarks

The Decision is clearly notable. It is undoubtedly the most significant abuse of dominance case in China after *Qualcomm* and *Tetra Pak*. When compared to previous decisions by the Chinese authority, one may argue that the Decision is relatively short, less detailed and at times seems to be (purposefully) using layman’s terms. It seems clear that the authority is keen to set out its position in a way that is clear for everyone to understand.

Alongside the Decision, interestingly, SAMR also issued an “administrative guiding opinion” (Opinion). The Opinion set out various actions for Alibaba to ‘correct’ its behaviour, urging Alibaba to conduct a comprehensive self-examination and commit to antitrust compliance. These “suggestions” go beyond what would be allegedly sufficient to redress the infringement identified in the Decision, such as requesting Alibaba to comply with merger control obligations, and not to use technology, platform rules, data, or algorithms to conduct anti-competitive agreements. While technically speaking, the Opinion itself does not have a legally-binding effect, it does clearly convey to Alibaba and all business operators in the platform economy SAMR’s position that antitrust infringement even by large tech firms will not be tolerated.

The Decision marks the beginning of a new era in China's antitrust enforcement, with a more assertive SAMR. The conclusions reached by SAMR in the Decision are likely to become the standards for future e-commerce platform cases in China.

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