DOI: 10.37420/j.mlr.2023.016

China's Anti-monopoly Enforcement Campaign Against Exclusionary Conduct of Two-Sided Platforms: A Case Study

Gao Huandong
School of Law, University of International Business and Economics, China
Corresponding author, e-mail: Huandong_Gao@163.com

Abstract

The topic of this article lies at the intersection of two concepts: two-sided markets and exclusionary conduct. Compared to the difficulty of defining a two-sided market, the lack of consensus regarding what constitutes exclusionary conduct is more problematic. Generally, conduct is exclusionary when it harms the competitive process by weakening the rival firm's ability to compete and the conduct does not constitute competing on the merits. However, what it means to "harm competition" or fail to "compete on the merits" is hotly debated. Judging alleged exclusionary conduct requires an in-depth analysis of the market and the means used to achieve or maintain the monopoly. For instance, the U.S. court has established an analytical mechanism (rule of reasons) to examine both anticompetitive effects and procompetitive justifications within a structured, burden-shifting framework. As a result, this article focuses on how the Chinese antitrust enforcers identify the exclusionary conduct of a firm operating in a two-sided market. Part I is the introduction; Part II traces the Sixteen-year history of Chinese antitrust law up to the present. Part III surveys the characteristics of individual cases of exclusionary conduct enforced in China. We examine how the Chinese enforcers establish their own "rule of reason" approach to justify the massive penalty imposed on the firms. Part IV concludes.

Keywords

Exclusionary Conduct, Two-sided Market, Anticompetitive Effects

Introduction

Starting from the events that Alibaba and Meituan have been massively punished by China's Regulator for exclusionary conduct in 2021, China's antitrust law, or specifically article 22, paragraph 4 thereof, enters a new "enforcement era." Platforms like Alibaba and Meituan, however, are not a new business model in China, but rather an old one that has been rejuvenated by the sheer scale and scope of the participants in the digital economy. The complexity this model creates is the "tipping" feature of two-sided markets. The tipping feature is a result of the two-sided market feedback mechanism. That is, in two-sided markets, increases in the market share on one side of the market attracts users from the other side, which attracts even more users from the original side.

The tipping feature of two-sided markets does not mean that competition is necessarily working effectively, however, nor does it mean that there is undetected anticompetitive conduct by firms. Yet, this feature com-

bined with exclusionary conduct brings problems to antitrust regulators that whether the tools traditionally used to define markets, assess market power and efficiencies, and assess the effects of exclusionary conduct and vertical restraints, remain sufficient to address those questions in the context of these two-sided markets. The recent enforcement wave against Alibaba and Meituan gives us a tremendous opportunity to observe how the Chinese regulator disposes and solves these challenges.

Among the challenges a regulator may encounter in the enforcement of a company's exclusionary conduct, the anticompetitive effect of such conduct is one of the most difficult parts. Like the U.S. court has established an analytical mechanism (rule of reasons) to examine both anticompetitive effects and procompetitive justifications within a structured, burden-shifting framework, the Chinese regulator, or specifically, the State Administration for Market Regulation (SAMR), is also trying to establish their own "rule of reason" approach to justify the massive penalty imposed on the high-tech companies.

Anti-monopoly Law Against Exclusionary Conduct in China

A. Substantiative Law

China's antimonopoly law prohibiting exclusionary conduct was promulgated in 2007 by the National People's Congress. It stipulates that "one party with a dominant market position shall be prohibited from restricting the other transactional parties only dealing with it without any justifiable cause." As one of the unlawful conducts accused of abusing dominant market position, the accused party must have dominance to "unilaterally raise prices above, or quality below, the competitive level."

In February 2021, SAMR issued the Anti-Monopoly Guidelines for the Platform Economy (Guidelines), providing tailored guidance on compliance with China's Anti-Monopoly Law. Focusing on the platform economy and China's leading tech firms, the Guidelines directs regulators in at least two ways: (1) defining relevant market and identifying dominant position in the context of e-commerce; (2) illegalizing "pick-one-from-the-two" (compelling participants to do their business only in one platform) as abuses of dominance. Additionally, as clarified in the Guidelines, SAMR is able to impose penalty (monetary relief) and enjoin the party from anticompetitive practices (injunctive relief).

B. Comments from Legal Academia

Although the antimonopoly law expressly bans exclusionary conduct since 2007, the platform economy has not come into the eyes of Chinese regulators for a long time. On October 24, 2020, Jack Ma (Alibaba's founder) made a highly controversial speech at the Bund Financial Summit in Shanghai that provided scathing criticisms of Chinese financial regulation. This speech directly challenged the legitimacy of the Chinese financial regulation and offended many senior officials. Since then, Chinese regulation has spread like wildfire, affecting not only the fintech sector, but also social media, e-commerce, ride-hailing, and food-delivery businesses. Anti-monopoly law against unlawful exclusionary conduct is one of the crucial battlegrounds of these enforcement actions. As we discussed in Part III, compared to other enforcement approaches, anti-monopoly law is more like a "policy tool" for the regulators against the tech firms. The harm to competition.

Qualitative Analysis of Notable Cases

A. Alibaba Case

On April 10, 2021, China's regulator—the State Administration for Market Regulation (SAMR) imposed a penalty of $2.78 billion on Alibaba Group Holding Ltd. (Alibaba) for its claimed exclusionary conduct. $2.78 billion accounting for four percent of Alibaba's domestic sales in 2019, was the largest ever imposed by the Chinese antitrust regulator. According to SAMR's investigation, Alibaba's conduct of implementing exclusive agreements hinders competition in China's online retail services market, impedes the free flow of goods, services, and resources, and infringes the legitimate rights and interests of online retailers as well as the interests of consumers. To further probe the rationale behind SAMR's decision, we will discuss Alibaba's concrete abusive conduct and its anticompetitive effects.

(a) The Facts that Alibaba Abused Its Monopoly Power

Based on SAMR's investigation, since 2015, to inhibit other competitors' growth, and consolidate its monopoly power, Alibaba abused its market dominant position in the online retail platform service market in China by implementing the strategy of "picking one from the two." The "picking one from the two" strategy aims to prohibit online retailers from opening new stores on other competitors' platform. The exclusive strategy also includes a variety of reward and punishment measures to ensure its implementation.

SAMR's investigation shows that the retailers within the platform are crucial for Alibaba to attract consumers and enhance its competitiveness. Alibaba can maintain its competitive advantage and market dominance by attracting more online retailers, which in turn will attract more consumers. According to factors such as sales growth, merchandise capability, and brand impact, Alibaba classified its online retailers into seven levels, including "SSKA," "SKA, "KA, "core waist, "waist," "long tail," and "bottom," of which KA and above retailers (hereinafter collectively referred to as "core retailers") are the "key ingredients" of its competitiveness. Alibaba requested core retailers to prohibit opening new stores on other competitive platforms to enhance their competitiveness and weaken competitors.

To enforce its exclusive strategy, Alibaba inserts several provisions in the agreement signed between the online retailers (especially the core retailers) and itself. According to SAMR's statement, since 2015, Alibaba has signed various agreements with some core retailers, such as the "Framework Agreement for Strategic Retailers," the "Joint Business Plan," and the "Memorandum of Understanding on Strategic Cooperation," which stipulate that "core retailers are not allowed to carry out e-commerce other competitive platforms." In addition, Alibaba also imposes a verbal obligation upon its online retailers who were required not to conduct business with Alibaba's competitors. SAMR states that because retailers strongly depend on Alibaba's online retail platform services, the oral agreement put forward by Alibaba are generally well enforced.

(b) Anticompetitive Effects of Alibaba's Exclusive Strategy

Alibaba inhibits retailers from opening stores on other competitive platforms or participating in marketing activities held by its competitors. SAMR believed that these restrictions Alibaba imposed on its online retailers formed a "lock-in" effect, allowing Alibaba to improperly maintain and consolidate its monopoly power.

Moreover, SAMR thought that Alibaba's illegal conduct also weakened the degree of competition within the same brand. When online retail retailers who sold the same brand product (like Lenovo's PC or Apple's cell phone) open different shores on various online platforms, they can form competitions between different sales channels within the brand. However, the intra-brand competitions can be eliminated if one platform requires retailers to sign an exclusive distributorship agreement with it.

(c) Alibaba's Exclusive Policy Caused Damages to Consumers.

Finally, SAMR stated that Alibaba's exclusive policy imposed on its online retailers harmed consumer welfare. In the context of online retail sales, asymmetric information of products is greatly reduced for consumers. Thus, it is much easier for customers to compare goods and prices between different platforms to make the best choice. However, Alibaba's exclusive policy cuts down the goods that can be selected on other competitive platforms, limits the scope of brands and products that consumers can access, and restricts consumers' right to free choice.

B. The Meituan Case

Six months after Alibaba's case, on October 8, 2021, SAMR enforced another notable case against food delivery giant Meituan with a $534.3 million penalty for abusing its dominant position. $533.5 million accounts for three percent of Meituan's 2020 domestic revenue. Mantuan was also ordered to immediately shut down its misconduct and give a full refund of an exclusive cooperation deposit of 1.29 billion yuan ($180.98 million) to contracted vendors. SAMR's investigation found Meituan had abused its monopoly market power since 2018. It forced online food vendors to sign exclusive agreements by implementing discriminating rates and threatening to postpone vendors' openings. To further study the rationale behind SAMR's enforcement, we will discuss Meituan's conduct and its anticompetitive effects pinpointed by the SAMR.

(a) Meituan's Exclusionary Conduct Condemned by the SAMR

Based on SAMR's investigation, since 2018, in order to restrain other competitive platforms and consolidate the market monopoly power in the online catering platform service market in China, Meituan implemented its exclusive strategy which obstructed online food retailers from opening new stores in its competitors. Like Alibaba, Meituan also adopted a variety of measures to ensure the implementation of its strategy. For example, Meituan compelled retailers to sign exclusive agreements with its platform which clearly stipulated that retailers on the platform need to "invest all their online marketing resources and energy into the Meituan platform" or "only establish a strategic business relationship with Meituan."

Moreover, to enforce its strategy, Meituan also leveraged deposits, algorithms, data, and other technical methods to ensure food vendors remained loyal to its platform. For instance, Meituan developed a big data system to automatically monitor and punish its vendors for doing business with its competitors. According to SAMR, since 2018, to apply its exclusive strategy, Meituan has developed a big data monitoring and analysis system, which can automatically monitor the vendor's commercial activities on other competitive platforms. Such a system could also automatically impose penalties on the vendors who violate the exclusive arrangement.

(b) The Anticompetitive Effect of Meituan's Exclusive Conduct

SAMR pointed out that Meituan's misconduct eliminated relevant market competition, and harmed the interests of online food vendors and consumers. Since 2018, Meituan has signed exclusive agreements with online food vendors on a large scale, restricting them from cooperating with other competitive platforms. Similar to Alibaba's motivation, considering food vendors and consumers are the core elements of competition between online food delivery platforms, Meituan abused their dominant market position to restrict a large number of retailers within the platform from doing business on other competitive platforms, making it impossible for other competitors to obtain a sufficient supply of retailers. Additionally, due to the two-sided market effect of online platforms business model, locking retailers within one platform will further reduce the number of consumers on other competitive platforms. SAMR's investigation shows that Meituan's implementation of the exclusive policy has effectively built competitive barriers, improperly weakening the competitiveness of other competitive platforms.

Another competition harm demonstrated by the SAMR is that Meituan unreasonably restricted the freedom of retailers and harmed the economic interests of food vendors. SAMR believed that the online food retailers generally tended to sell on multiple platforms to cover consumers more widely and obtain more transaction opportunities. Meituan have a dominant market position in the relevant market which makes it indispensable for most online food vendors. Thus, vendors were forced to accept Meituan's exclusive policy and gave up the business opportunities on other food delivery platforms.

Furthermore, SAMR also emphasized that Meituan's policy improperly extracted economic benefits from food vendors. Likewise, Meituan makes it impossible for vendors to carry out multi-platform sales, which reduces the business income that retailers may gain through other marketing channels. At the same time, Meituan imposed various punishment measures to compel vendors on its platform to deal merely with it.

Finally, SAMR also believed that Meituan exclusionary conduct makes it impossible for food vendors to cover consumers. Thus, its exclusionary policy in turn restricted consumers' free choice, and harmed consumer welfare. For instance, Meituan's conduct prevented consumers from obtaining better prices and services from the online food delivery market. Under the circumstance that food vendors had access to all the online food delivery platforms, consumers could obtain better prices and services through competition among different platforms. Because Meituan restricted retailers from cooperating with other competitive platforms, consumers could only passively accept the trading conditions of Meituan's platforms and could not obtain better prices and services under fair competition conditions among different platforms.

C. Reflections: Law Enforcement Campaign on Exclusionary Conduct

As we discussed above, the Alibaba case is the first time that the Chinese regulator recognized the anticompetitive effect of "pick-one-from-the-two" agreements and its violation of the Anti-Monopoly Law. Two weeks after SAMR fined Alibaba, it has opened its second-ever antitrust investigation into Meituan. The current anti-monopoly enforcement campaign is not a newly born appearance in China. Since 1949, campaigns deployed by the Chinese politician are in a wide range of legal areas, such as crime and punishment, anti-corruption, environmental protection, and financial regulation. However, comparing to other enforcement campaigns, the current enforcement wave against e-commerce tech company is more result oriented. The rationale that SAMR fined Alibaba and Meituan remains controversial in several aspects.

First, harm to social welfare (or consumer's welfare) is due to harm to competition. To distinguish exclusionary behavior from competitive behavior, one leading approach is to label conduct as exclusionary if it (a)

harms competition, and (b) reduces some measure of social welfare (e.g. consumer surplus or total surplus) relative to a baseline in which the conduct is not undertaken. In the cases of Alibaba and Meituan, SAMR believed that the "picking one from two" conduct harmed consumer welfare since their exclusionary policy restricted consumers' free choice (purchase goods from other competitor's online platform). However, consumers' free choice may not be always necessary for enhancing consumers welfare. In most cases, consumers are just chasing for a cheaper price and indifferent to how many platforms they could browse. On the other hand, the undefined notion of harming competition, once overstressed, may also distort the behavior of both potential excluders and their targets.

In addition, except social welfare theory, SAMR hardly mention a word regarding any actual loss to the two defendants' real or potential competitors. In SAMR's Penalty Decision, it states that the defendants' exclusionary conduct caused damage to the retailer and food vendor who are selling their products or providing services through defendants' platform. Unfortunately, retailer and food vendors are not competitors of the defendants. The real competitors in the relevant market are Tiktok and Pinduoduo. In fact, the as-efficient-competitor test is a frequently used tool for regulators to ask whether an equally efficient rival could compete successfully in the presence of the alleged conduct. If the answer is yes, then by this test the alleged conduct is not exclusionary. In the decision-making process of SAMR, the as-efficient-competitor test is not applied in the cases we discussed.

Lastly, another widely proposed test for exclusionary behavior is the no-economic-sense test. This test limits the scope of exclusion to conduct that makes no economic or business sense but only for the likelihood of harming competition. Because this test focuses on the economic welfare of the potential defendant, it does not suffer from some of the problems associated with tests based in whole or part on consumer or rival welfare. Unfortunately, in the cases decided by the SAMR, the no-economic-sense test are not be formally considered as well. This is dangerous for a regulatory authority since in many cases (like predatory pricing case) the defendant will argue that it is simply "competing on the merits."

Conclusion

The recent wave of anti-monopoly enforcement against high-tech firms in China provides an opportunity for scholars to study the analytical framework of exclusionary conduct. According to the SAMR's allegation, the alleged behavior's anticompetitive effect is mostly because it harms consumer welfare (in the form of limiting consumer's free choice), and the injury of retailers and vendors on the defendant's platform. However, SAMR hardly discusses whether the defendant's conduct harms his competing platform. As we stated in Part III, there is no economic tools (for example, the as-efficient-competitor test and no-economic-sense test) have been applied to test the anticompetitive effect on the defendant's competitors. Thus, the lack of economic analysis may bring a common argument to SAMR's enforcement that anti-monopoly cases currently decided in China are more like a "policy tool" for the regulators against the local Chinese tech firms.

references

[1] Zhong, R. (2021), China Fines Alibaba $2.8 Billion in Landmark Antitrust Case, N.Y. Times, https://www.nytimes.com/2021/10/08/technology/china-meituan-antitrust-fine.html.

[2] Anti-monopoly Law. (2008), art. 22, CLI.1.5128034(EN) (Lawinfochina).
[3] For theoretical literature on exclusive and non-exclusive contracts recognizes the tipping feature, Armstrong, M. & Wright, J. (2007). Two-sided Markets, Competitive Bottlenecks and Exclusive Contracts, Economic Theory (32) 353. also Asker, J., & Bar-Isaac, H. (2014). Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals. American Economic Review, 104 (2), 672-686.
[4] Chica C., Chuk, K. & Tamayo, J. (2021). Exclusive Dealing and Entry by Competing Two-Sided Platforms, Harvard Business School.
[5] OECD (2018), Rethinking Antitrust Tools for Multi-Sided Platforms, www.oecd.org/competition/rethinking-antitrust-tools-for-multi-sided-platforms.htm.
[6] OECD (2020), Abuse of Dominance in Digital Markets, https://www.oecd.org/daf/competition/abuse-of-dominance-in-digital-markets-2020.pdf.
[7]Guidelines of the Anti-monopoly Commission of the State Council for Anti-monopoly in the Field of Platform Economy. (2021), CLI.4.352590(EN) (Lawinfochina).
[8] Chen, Y. (2022). Antitrust Remedies: A Comparison Between the Cases Against Alibaba and Facebook. Colum. J. Asian L., 35, 229.
[9] Zhang, A. H. (2022). Agility over stability: China's Great Reversal in Regulating the Platform Economy. Harv. Int'l L.J., 63, 457.
[10] Yang, J. & Wei, L.L. (2020, Nov. 12) China's President Xi Jinping Personally Scuttled Jack Ma's Ant IPO, Wall St. J., https://www.wsj.com/articles/china-president-xi-jinping-halted-jack-ma-ant-ipo-11605203556.
[11] Yang S. (2021). China's Tech Clampdown Is Spreading Like Wildfire, Wall St. J., https://www.wsj.com/articles/chinas-tech-clampdown-is-spreading-like-wildfire-11622971802.
[12] The State Administration for Market Regulation (SAMR) Issued an Administrative Penalty Decision and Administrative Guidance for Alibaba Group Holding Co., Ltd.'s Monopoly Case in the Online Retail Platform Service Market in China, https://www.samr.gov.cn/zt/qhfldzf/art/2021/art_74b2593fd32a432baf3dcbd163935167.html.
[13] China's Top Market Regulator Imposes Penalty on Alibaba Group over Monopoly Conduct, Xinhua (2021), https://english.www.gov.cn/statecouncil/ministries/202104/10/content_WS60713c0dc6d0719374afc5b6.html.
[14] SAMR Requires Alibaba to Change and Revise Thoroughly, Xinjingbao. (2021). https://baijiahao.baidu.com/s?id=1696616703718464551&wfr=spider&for=pc.
[15] The State Administration for Market Regulation (SAMR) Issued an Administrative Penalty Decision and Administrative Guidance Against Meituan's Monopoly Case in the Food Delivery Platform Service Market in China. (2021). https://www.samr.gov.cn/zt/qhfldzf/art/2021/art_20d2233982c843f58681b40674441050.html.