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# China—The *Baidu* Decision

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The *Baidu* case, one of the first abuse of dominance cases in China, is important in several respects. First, it was one of the first private competition law actions in China. Second, the judgment was read out in a real-time broadcast. Third, the legal reasoning was more detailed than in other competition law cases. Fourth, the Court stressed the importance of economic reasoning and evidence in deciding such cases. This paper analyzes both the facts of the case and its significance.

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## I. Introduction

In November 2008, Tangshan Renren Information Service Co Ltd (“Tangshan Renren”) complained to the Chinese State Administration of Industry and Commerce (“SAIC”) alleging that Beijing Baidu Netcom Science and Technology Co Ltd (“Baidu”) had abused its dominant position, contravening the Chinese Anti-Monopoly Law that had come into force on August 1, 2008. As a result of the lack of a public response from the SAIC, Tangshan Renren commenced a private action in April 2009 against Baidu, the largest internet search engine provider in China.

On December 18, 2009, the Chief Justice of the Beijing First Intermediate Court publicly announced the Court’s decision on Tangshan Renren’s claim, one of the first cases of abuse of dominance in China under the Chinese Anti-Monopoly Law. Tangshan Renren’s case against Baidu centered on allegations that Baidu, an internet search engine, had abused its dominant position in the search engine market. According to Tangshan Renren, Baidu reduced the visibility of Tangshan Renren’s website to Baidu users to induce Tangshan Renren to inject more advertising fees into the search engine’s advertisement platform.

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The case is important in several respects. First, it was one of the first private competition law actions in China. Second, the judgment was read out in a real-time broadcast. Third, the legal reasoning was more detailed than in other competition law cases. Fourth, the Court stressed the importance of economic reasoning and evidence in deciding such cases.

## II. Some Background on Search Engines

Search engines help users find information. For example, Google stores (“caches”) web pages on its own computers (“servers”) and indexes the information. Information is updated by sending automated “spiders” or “crawlers” onto the Web. When a user enters a search term, Google searches its own cached content with its own index, not the Web itself.<sup>1</sup> Advertising is provided on Google’s own websites. Advertising pays search engines. As Moffat points out:

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“Advertisers were estimated to spend eleven billion dollars on advertising with search engines in 2008, reflecting the sheer economic power of the industry. Indeed, an entirely new industry, search engine optimization (“SEO”), has arisen to assist website owners in improving their rankings in search engine results, a fact that emphasizes search engines’ role as a gate-keeper and driver of the online economy.”<sup>2</sup>

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Search engine users do not pay to conduct searches on search engines; rather, advertisers pay to have their advertisement appear either generally or with specific search terms.

### III. Facts of the Case

Tangshan Renren operates a medical information website. Baidu operates an internet search engine that provides free search services to its users. Like most other search engines, the considerable investment in technology and infrastructure is funded through supplying paid advertising platforms to advertisers and website owners.

Search companies such as Baidu use auction-based advertising programs that allow advertisers to target advertisements to specific search keywords. At the start of the “dot.com revolution,” advertisers paid for online advertisements on a “cost-per-impression” basis, i.e. advertisers paid for the number of times a page containing the advertising was displayed. However, with the evolution of the online advertising market, web publishers and search engines developed new revenue earning methods. As Ratliff and Rubinfeld describe:

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“[The online advertisement market] changed in 1998, when the search engine GoTo.com was launched. GoTo.com broke with CPM [“Cost Per Mille”] pricing, instead auctioning the top results of its search-result pages, with advertisers’ sites appearing in descending order of their bids (on a pay-per-click basis). GoTo used a real-time competitive bidding process to allocate listing priorities.”<sup>3</sup>

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Increasingly, now, advertisers are charged “per click” on an advertisement rather than on the number of users that see the webpage with the advertisement.

Baidu uses two systems to rank and display search results. The first ranks on the basis of key-word matches, the second on the basis of a “bid” ranking system where the ranking is dependent on the amount of advertising fees paid for the Pay for Placement (“P4P”) program. Under the P4P advertising, paid advertisements appear alongside internet search results. Advertisers bid for the right to place an advertisement and those who pay more have their advertisements displayed more prominently on the webpage. Internet users of Baidu and other search engines want a “neutral” search engine in the sense that the search engine selects web pages to display objectively on the basis of keyword matches and successful bids. However, search engines can be manipulated to give priority to other objectives.

For example, in a complaint to the European Commission in early 2010, it was alleged that Google used its search engine to give priority in search results to its own services such as its own price comparison and video services.<sup>4</sup>

Tangshan Renren initially paid fees to Baidu to increase its page ranking by participating in the P4P system. Tangshan Renren alleged that from May 2008, after it reduced its “bid” payments to Baidu, as a retaliatory measure for the drop in payments from Tangshan Renren and in order to induce Tangshan Renren to reinstate its fee payments, Baidu abused its dominant position by using a penalty filter to lower its website rankings.

Penalty filters are tools used by search engines to stop “spamdexing” (i.e. deliberately modifying web pages to increase the chance of them being higher in search engine results or influencing the categories to which a web page is assigned) or to prevent against sites attempting to manipulate the search engine’s algorithms.

## IV. The Claim

Tangshan Renren alleged that Baidu had infringed Article 17(iv) of the Anti-Monopoly Law by taking measures to reduce Tangshan Renren’s ranking in its search results to coerce Tangshan Renren’s continued participation in the P4P program.

Article 17 of the Anti-Monopoly Law states as follows:

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“Undertakings with dominant market positions are prohibited from committing any of the following acts that abuses dominant market positions:

- (i) selling products at unfairly high prices or buying products at unfairly low prices;
  - (ii) without valid reasons, selling products at prices below cost;
  - (iii) without valid reasons, refusing to trade with trading partners;
  - (iv) without valid reasons, restricting trading partners to only trade with the undertaking or undertakings designated by the undertaking;
  - (v) without valid reasons, tying products or imposing other unreasonable trading conditions during the deals;
  - (vi) without valid reasons, applying differentiated treatment in regards to transaction conditions such as trading prices to equivalent trading partners; or
  - (vii) other abuses of dominant market position determined by the Anti-Monopoly Law Enforcement Authority under the State Council.”
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Article 17(iv) prohibits a dominant firm from engaging in exclusive dealing. It is difficult to see why the allegations were based on Article 17(iv) rather than 17(vi) which deals with discrimination. This will be discussed later.

## V. Market Definition in Baidu

In order to assess whether Baidu is dominant and the anticompetitive effects (if any) of Baidu's conduct, the relevant market must first be defined.

Tangshan Renren had claimed, in its action, that the relevant market was the "Search Engine Service Market in China."

Baidu argued that "as the search engine service is free for internet users, which is not subject to Anti-Monopoly Law, there is no relevant market under the Anti-Monopoly Law." The Court rejected this because free internet services are closely combined with paid services. According to the Court,

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"[t]he free search service provided by search engine providers to internet users is not equivalent to a free service for charity, and may obtain actual or potential commercial benefits by attracting internet users and employing advertisement or other marketing services."

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In determining the relevant market in the case, the Court looked to Article 12.2 of the Anti-Monopoly Law which provides as follows:

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"'Relevant market' in this Law refers to the scope of products and areas within which the undertakings compete against each other during a certain period of time with respect to relevant commodities or services."

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The Court further relied on the economic test in Section 3 of the "Guidelines for the Definition of Relevant Market" issued by the Anti-Monopoly Commission of the State Council in May, 2009. These Guidelines refer to relevant product and geographic markets in terms of "close substitutability" where a "relevant product market" consists of categories of products that may be substituted for one another based on product characteristics, use, and price; and a "geographic market" consists of the area(s) in which substitute products may be

obtained. This test is not dissimilar to the Hypothetical Monopolist or “SSNIP” (Small but Significant and Non-transitory Increase in Price) tests used by other competition law / antitrust jurisdictions.

Administering the test, the Court agreed with Tangshan Renren that the relevant product market was the search engine market in China. The geographic market was limited to China due to cultural and language differences. According to the Court, “search engine service means an internet information inquiry service in which the service provider accepts the search request of internet users, operates an internet application software system, searches, caches, processes and organises relevant webpages, and provides the search result to the internet users.” However, the Court held that internet search engine services are not “closely related to internet news services, real-time communication services and other internet services to form a relevant market.”

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## VI. Search Engines and Market Definition

Internet Search engines operate in two-sided markets. That is, an economic network that has two distinct user groups (advertisers who pay and users who do not) who provide each other with indirect network benefits. In two-sided markets, users on each side of the platform typically require very different kinds of functions from the platform. Search engine users want to be able to conduct efficient relevant searches. Advertisers want an avenue or medium in which they can effectively broadcast their advertisements to a wider and targeted audience.

Market definition is more complicated where two-sided markets are involved because both sides of the market must be taken into consideration when delineating the scope of the market. As Evans elucidates:

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“The fact that one or more subjects of the inquiry are two-sided platforms does not fundamentally alter market definition analysis. However, the interdependence between the two sides of a platform and the products and businesses relevant to both sides must be considered.”<sup>5</sup>

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On the one side the market should be looked at according to the search engine services, on the other the focal service is that of advertising.

Search engines such as Baidu, Google, and Yahoo are widely used by internet users to browse for web pages relevant to their searches. The popularity of search engines used depends largely on the search functions provided, ease of use, accuracy, range of results, and, most importantly, the language and geography.

In relation to advertising, search engines and online advertising media are likely to compete with offline media such as advertisement space in newsprint and advertising slots in television broadcast, as well as other forms of online media attached directly to web pages.

MARKET DEFINITION SHOULD BE UNDERTAKEN IN RELATION TO THE CONDUCT COMPLAINED ABOUT.

As such, it is not clear why Tangshan Renren argued that this case defined a search engine market. Market definition should be undertaken in relation to the conduct complained about. Tangshan Renren bought advertising space on Baidu's P4P program, but subsequently reduced the fees paid. Tangshan Renren complained that Baidu, as a result of its reduction in fees paid, had blocked the display of Tangshan Renren's webpage in the keyword search results. The commercial relationship between Tangshan Renren and Baidu was the purchase and supply of advertising space. It would have been more appropriate to have argued some kind of internet advertising market.

## VII. Is Baidu Dominant?

Article 19 of the Anti-Monopoly Law contains a rebuttable presumption that firms with greater than 50 percent market share are dominant. Tangshan Renren provided two articles in support of its proposition that Baidu had a market share of greater than 50 percent.

The first, an article published in the Company News column at [www.baidu.com](http://www.baidu.com) on October 23, 2008, entitled *Baidu Q3 User Number Approaching 200,000, Pay Search Growing Steadily*, stated that "as indicated by third party statistics, the turnover of search engine advertisement market in China reached RMB2.73 billion in 2007, and will grow by 80% in 2008 as compared with 2007..."

The second, a *China Securities Journal* article dated 17 September 2008, stated that according to analysts,

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"as the largest Chinese search engine in the world, Baidu had secured more than 70% share of the search engine market, and was the single brand company with the highest usage in all websites in China. Advertisements on the



Baidu platform may extend to all internet users in China, which was also the reason for the steady and rapid growth of its pay search business.”

The Court clarified that the factors considered by the Court in assessing dominance included market share, competitive structure of the market, the ability of Baidu to control sales in the market or the supply of raw materials, Baidu’s financial and technological strength, barriers to entry, etc. However, the Court held that “it is impossible to determine whether the definition of the relevant market as the basis of the ‘market share’ mentioned in the two articles is the same as the definition of the relevant market in this case.”

The articles use such terms as “paid inclusion search” and “search engine advertisement market” which would have been appropriate if the relevant market was defined in advertising terms. It seems, from the limited evidence tendered that the plaintiff’s lawyers may have lacked experience in defining relevant markets for competition law purposes. For example, from the judgment, it appears that the presence or lack of alternative search engine advertisement platforms or other online advertising media in Chinese (i.e. substitutable products / services) or the use and popularity of the same, were not discussed at all. This is not surprising given the newness of the Anti-Monopoly Law.

THE ARTICLES USE SUCH TERMS AS “PAID INCLUSION SEARCH” AND “SEARCH ENGINE ADVERTISEMENT MARKET” WHICH WOULD HAVE BEEN APPROPRIATE IF THE RELEVANT MARKET WAS DEFINED IN ADVERTISING TERMS.

## VIII. If Baidu Were Dominant, Did It Abuse That Dominance?

The Court, despite its finding that Baidu was not dominant, discussed the abuse issue as well. Tangshan Renren alleged that Baidu had, by reducing the number of hits on its website, infringed Article 17(iv) of the Anti-Monopoly Law by “without valid reasons, restricting trading partners to only trade with the undertaking or undertakings designated by the undertaking.”

Baidu admitted that it used technical measures such as “reducing caches” or reducing the number of hits on Tangshan Renren’s website as a defense against spamdexing. This fact was not disputed. However, Baidu defended its actions as counteractions or defenses against spamdexing on Tangshan Renren’s websites. According to Baidu, when the Baidu search engine displays search results according to the key words entered by internet users, the list of standard search hits will appear on the left side of the webpage, and the list of paid inclusion hits will appear on the right side of the webpage, provided that on the first page of search

results, some paid inclusion hits may appear in the list on the left side of the webpage with the standard search hits. This means that fees paid for the P4P program would have little or no effect on the page rankings for standard search hits.

HOWEVER, BAIDU DEFENDED ITS ACTIONS AS COUNTERACTIONS OR DEFENSES AGAINST SPAMDEXING ON TANGSHAN RENREN'S WEBSITES.

Further, in the column *Webpage Search Help-Manager Frequently Asked Questions* (“FAQs”) at Baidu’s website [www.baidu.com](http://www.baidu.com), the terms and conditions of Baidu’s page ranking display read as follows:

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“What kind of webpages will be determined by Baidu as valueless, not cached by Baidu and removed from the current search results? Baidu only caches webpages having value to users, and the existence, removal and change of any links to the webpage in the search result is the result of the algorithm calculation and adjustment. The following types of webpages are expressly not welcome in Baidu: Webpages manipulating the results displayed by search engines, creating content appearing in the search result which is different from the actual content of the webpage, or enabling the webpage to obtain an improper placement in the ranking of the search results, to deceive the user.”

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According to Baidu, the creation of spam links falls within such category of “unwelcome” web pages. Indeed, the Court found that Tangshan Renren’s webpage contained many spam links and so Baidu’s actions to reduce hits on it were justified. The Court found, also, that Tangshan Renren failed to prove that the reduced hits on its webpage were due to Tangshan Renren’s reduced payments to Baidu.

## IX. Exclusive Dealing vs Discrimination

As stated above, it is peculiar that Tangshan Renren had chosen to rely on Article 17(iv) of the Anti-Monopoly Law. Article 17(iv) of the Anti-Monopoly Law deals with exclusive dealing where a party is “coerced” into dealing with the dominant undertaking or an undertaking designated by a dominant undertaking. Tangshan Renren had alleged that by reducing its page ranking Baidu had sought to “coerce” Tangshan Renren into participating in the P4P program.

However, from the judgment, Tangshan Renren failed to demonstrate that, apart from Baidu, it did not have any other avenue in which it could advertise its website and a reduction in its page rankings on Baidu would have adversely

affected Tangshan Renren's business such that it would leave Tangshan Renren with little option but to invest in the P4P program. Indeed, to the contrary, Tangshan Renren demonstrated to the Court that a Google search generated 6690 hits referring to its website, indicating that the Google search engine was a possible alternate avenue for Tangshan Renren to reach out to internet users.

It is, moreover, unclear why Tangshan Renren failed to argue that Baidu had breached Article 17(vi) of the Anti-Monopoly Law, which prohibits discriminatory conduct on the part of dominant undertakings. Although the sustainability of such an argument is hypothetical, a *mala fide* retaliatory (and hence, discriminatory) reduction in Tangshan Renren's page ranking in the standard search function as a result of its reduced participation in the P4P program may well be an easier argument to prove where there are no commercial justifications for a reduction in the page ranking.

IT IS, MOREOVER, UNCLEAR WHY TANGSHAN RENREN FAILED TO ARGUE THAT BAIDU HAD BREACHED ARTICLE 17(VI) OF THE ANTI-MONOPOLY LAW, WHICH PROHIBITS DISCRIMINATORY CONDUCT ON THE PART OF DOMINANT UNDERTAKINGS.

## X. Conclusions

Market definition was not extensively discussed in the judgment as the Court agreed with the plaintiff. It is difficult to understand why an advertising market was not argued. If so, then one of the articles submitted on market share may have been relevant to showing dominance in some kind of online advertising market.

Most commentators have welcomed the greater transparency from the global broadcast of the decision on the Chinese media and the internet and the Court's willingness to use economic analysis in its decision. This is certainly to be lauded. However, during the decision, arguments and discussion of the relevant market and indeed what constitutes abuse of a dominant position in this situation in the Court proceedings, were limited. Overall, the proceedings were conducted in a very short period of time. There does not seem to have been much evidence introduced nor were experts brought by the parties to assist the Court in understanding the economic issues, given the novelty of the Anti-Monopoly Law. This is a pity in such a highly technologically advanced and fast-moving industry.

Finally, the wisdom of having private rights of action in such a new and complex area of law can be questioned, given the expertise needed to advocate and adjudicate on such matters, without guidance from a competition regulator. Other countries such as Singapore initially did not permit private actions to determine breaches of its competition law on the grounds that inexperienced judges could lead to decisions and create precedents that might inhibit future

competition. The European Union, Vietnam, and South Africa have similarly relied more on specialized Commissions than the courts to administer and enforce competition law.

Although there is no “one-size-fits all” model, given China’s size and given that enforcement of laws in China is generally handled through decentralized administrative decisions, private actions may well give rise to inconsistent enforcement across the country. However, competition law cases may be increasingly referred to specialized courts. In December 2008, a special “monopoly division” was set up inside the Shanghai No. 2 Intermediate People’s Court. Elsewhere, cases brought under the Anti-Monopoly Law are dealt with by two different Divisions. Civil claims are dealt with by the intellectual property law division while administrative claims are dealt with by the administrative law division. The Shanghai Court initiative, “a pilot program blessed by the Supreme People’s Court with an aim to promote judicial expertise in this area,”<sup>6</sup> is an important step. This development is to be welcomed and will encourage legal practitioners in China to foray into the arena of competition law and gain legal expertise in complex areas such as the economics of digital media and market definition for two-sided markets; and, indeed, for economic consultants to do likewise. The challenge for the courts will be in surmounting the limited access to economic expertise in newly developing, high-technology markets where the costs of making wrong decisions can be considerable. ▼

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- 1 For an explanation of how Google works see: [http://www.googleguide.com/google\\_works.html](http://www.googleguide.com/google_works.html).
  - 2 Viva R. Moffat, *Regulating Search*, 22(2) HARV. J.L. & TECH. 475-513 at 481-2 (Spring 2009).
  - 3 James D. Ratliff & Daniel L. Rubinfeld, *Online Advertising: Defining Relevant Markets*, 6(3) J. COMPETITION L. & ECON. 653-686, (Sept. 2009).
  - 4 Times Online, *EU launches antitrust inquiry into Google ‘dominance’* (February 24, 2010), available at [http://business.timesonline.co.uk/tol/business/industry\\_sectors/technology/article7038845.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/technology/article7038845.ece).
  - 5 David S. Evans, *Two-Sided Market Definition*, ABA Section of Antitrust Law, MARKET DEFINITION IN ANTITRUST: THEORY AND CASE STUDIES, (forthcoming), available at <http://ssrn.com/abstract=1396751>.
  - 6 Oliver Zhong, *Dawn of a New Constitutional Era or Opportunity Wasted? An Intellectual Reappraisal of China’s Anti-Monopoly Law*, (April, 2010), available at: <http://ssrn.com/abstract=1596814>.