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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: CR015Apr16/Exc150Aug17

In the complaint referral between:

The Competition Commission	APPLICANT
and	
ZTE Corporation South Africa (Pty) Ltd	FIRST RESPONDENT
and	
ZTE Mzanzi (Pty) Ltd	SECOND RESPONDENT

In re:

The exception application between:

ZTE Corporation South Africa (Pty) Ltd	APPLICANT
and	
The Competition Commission	RESPONDENT

Panel	: Norman Manoim (Presiding Member) : Enver Daniels (Tribunal Member) : Mondo Mazwai (Tribunal Member)
Heard on	: 27 November 2017
Reasons Issued on	: 7 May 2018

Reasons for Decision

INTRODUCTION

[1] These reasons relate to an exception application brought by the first respondent, ZTE Corporation South Africa (Pty) ("**ZTE SA**") Ltd, in which it sought to dismiss the Commission's complaint referral or alternatively sought to require the Commission to cure the defects of its complaint referral by supplementing it.[1]

[2] We have decided to refuse the exception. In these reasons we explain why.

BACKGROUND

[3] In the main matter, the Commission brought a case in terms of section 4(1)(b)(ii) of the Competition Act 89 of 1998, ("the Act") against ZTE SA and ZTE Mzanzi, the second respondent. In essence, the Commission alleges that ZTE SA and ZTE Mzanzi are competitors who contravened the Act by allocating customers. The Commission only sought relief against ZTE SA in the complaint referral, as ZTE Mzanzi ("**Mzanzi**"), is the Commission's corporate leniency applicant.

[4] The history of these two firms is important to understanding the dispute that has given rise to this exception. ZTE China ("China Corp.") a Chinese firm, manufactures telecommunications equipment. Originally it had appointed ZTE SA as its sole local distributor in South Africa. At some stage ZTE SA took on a BEEE shareholder, 8 Mile Investment 411 (Pty) Ltd ("**8 Mile Investments**"), which acquired a 32% stake in ZTE SA. Due to disagreements among the shareholders, 8 Mile Investments, China Corp and ZTE SA, agreed that 8 Mile investments would exit its investment in ZTE SA and another company would be formed which would exclusively service public enterprises. This company became Mzanzi. China Corp whilst indirectly owning all of ZTE SA also acquired an indirect 40% shareholding in Mzanzi, with the balance being held by 8 Mile Investments.

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[1] Note although ZTE SA is the applicant in this interlocutory matter it is the first respondent in the complaint referral from which this exception arises. To avoid confusion we will refer to it as ZTE SA.

[5] The following facts are common cause:

a. ZTE SA and Mzanzi are both distributors of telecommunications equipment and network solutions including equipment used by network operators. The equipment sold by both ZTE SA and Mzanzi is manufactured and supplied by China Corp.

b. A memorandum of understanding ("**MOU**") was concluded between China Corp., ZTE Hong Kong and 8 Mile Investments in December 2010. This agreement provided for 8 Mile Investments to exit ZTE SA and form a new company which would acquire the public enterprise business from ZTE SA. Although not identified then, this company was to become Mzanzi.

c. The MOU also contemplated that further agreements would be concluded between the parties to it. A supply agreement was then concluded between China Corp. and Mzanzi in August 2011. In terms of this agreement Mzanzi was appointed by China Corp as the exclusive supplier of its equipment to what were defined as "designated customers". The agreement precluded China Corp. and its subsidiaries from selling to designated customers. Designated customers were defined as those in the public sector and included Telkom.

[6] In its complaint referral the Commission links the MOU and the supply agreement. It alleges that together they led to a market division in the supply of telecommunications equipment between two competitors, ZTE SA and Mzanzi. It also relies on an understanding that exists between the two firms that Mzanzi would confine itself to the designated customers and not compete with ZTE SA for its customers. (Note this understanding is not expressly referred to in the agreements.)

[7] The Commission submitted that these two agreements and the understanding between Mzanzi and ZTE SA viewed collectively amount to a contravention of section 4(1)(b)(ii) of the Act. In terms of that provision, an agreement between competitors to divide markets by allocating customers, constitutes a prohibited horizontal practice.

[8] ZTE SA, in its answer to the complaint referral, does not dispute that the MOU and supply agreement had been concluded. But it argued that neither agreement could be relied upon to infer a horizontal relationship between the two firms. It submittted that Mzanzi was not a party to the MOU, while ZTE SA was not a party to the supply agreement. In brief, it argued that the supply agreement is an agreement between a manufacturer and supplier and the exclusivity of designated customers is incidental to the vertical supply agreement.[2] It also argued that ZTE SA and Mzanzi , could not become competitors, as Mzanzi could not supply the market without the supply arrangement, whilst ZTE SA could not enter Mzanzi's market as it lacked empowerment credentials.[3]

The Exception

[9] Sometime after the filing of the answering affidavit, the Commission called for a pre-hearing for the purposes of setting a timetable for the hearing of this matter. This pre-hearing was subsequently held on 1 August 2017. At the pre-hearing, the legal representative for ZTE SA advised the Tribunal, for the first time, that it intended to bring an exception application, despite having already answered the Commission's referral. The Commission's counsel did not raise an objection to this and a timetable for further proceedings that provided for the exception to be heard first was accordingly set.

[10] ZTE SA then brought its exception application in which it sought to dismiss the complaint or alternatively require the Commission to amend its complaint referral and supplement its papers.

OUR ANALYSIS

[11] As noted earlier ZTE SA has been able to file an answering affidavit in this case. It did not, in that affidavit raise the exception it does now. Thus considerations as to whether the case made out by the Commission in the

[2] Para 23.1 and 26.2 of answering affidavit
[3] Para 25 and para 26.2 of answering affidavit

complaint referral were sufficient to enable it to plead do not arise. ZTE SA was able to file its answer.

[12] This of course does not deprive ZTE SA from arguing at this stage, prior to the hearing that the Commission has not made out a cause of action. However, in terms of our case law if it chooses to do so it must argue on the basis that the facts put up by the Commission are correct but nevertheless do not disclose a cause of action.

[13] The essence of the argument is that ZTE SA and Mzanzi are not competitors and hence could not have effected a market division in contravention of section 4(1)(b)(ii). Second, it alleges that the supply agreement on which the Commission relies to establish the horizontal relationship is a vertical agreement between a supplier and its customer.

[14] Let us examine each of these points in turn. The argument that the two firms are not competitors hinges on the fact that according to ZTE SA it could not have competed for public sector contracts – the market it says is only open to firms with the requisite empowerment credentials and since it did not have them but Mzanzi did, the two firms could not have competed with one another.

[15] Since this case was being decided on exception ZTE SA had to make out a case why the firms could not compete in the designated market on legal grounds. The argument was that because the designated customers were those in the public sector ZTE SA could not supply them as it did not have any empowerment credentials whilst Mzanzi did. We were not referred to any statutory or regulatory provision which suggested this. Mzanzi's empowerment status may have given it a competitive advantage in this sector, but that is a different matter from ZTE SA being legally excluded. This then moves this dispute from one which can be solved by simple application of law to one of fact. This makes this point one that cannot be resolved on exception but must be left open to trial.

[16] The second point was that the alleged market division is the subject of the supply agreement. The supply agreement it contends is one concluded

between China Corp and Mzanzi and thus between two parties in a vertical relationship. Since ZTE SA is not a party to this agreement it cannot be relied on by the Commission to conclude the existence of a horizontal agreement between ZTE SA and Mzanzi, the two alleged competitors.

[17] This characterisation depends on the facts - mere legal form is insufficient given the nature of the agreement in question and the history underlying its conclusion. A horizontal agreement between competitors may be effected by way of a vertical agreement with a third party. In this case, the supplier is a shareholder in both competitor companies and was a party to the MOU. The supplier controls what the agreement describes as its associated companies namely ZTE Hong Kong and ZTE SA, and undertakes, on their behalf, not to sell or distribute products to the designated customers. This goes further than a simple vertical relationship. In this guise the controller of the competing firm (China Corp) is making undertakings to an alleged competitor on its subsidiary's, (ZTE SA's) behalf. *Prima facie*, this shows an apparent agreement between the controller of a competitor and its potential rival not to compete for the sale of products to the so-called designated customers.

[18] ZTE SA may well be able to explain that this agreement does not have the effect the Commission contends for. But they need to lead evidence to do so. It is not a matter that can be decided on exception where the facts of the Commission must be accepted.

[19] Moreover the Commission goes further than its reliance on the terms of the two agreements. It also alleges in paragraph 26 of the referral the following: *"It was also an understanding between ZTE SA and ZTE Mzanzi that ZTE Mzanzi would not market telecommunications equipment and network solutions to any other entity outside the designated customers and ZTE SA would not market similar products to any designated customers."* [4]

[20] Thus here the Commission further relies on the existence of an understanding between the firms as a basis for alleging that Mzanzi had in

[4] Our emphasis.

turn agreed not to compete with ZTE SA for the latter's customers. Hence it does not rely solely on the agreements to make its case for an alleged market division. Again whether or not the Commission will be able to do so, will be an issue for trial.

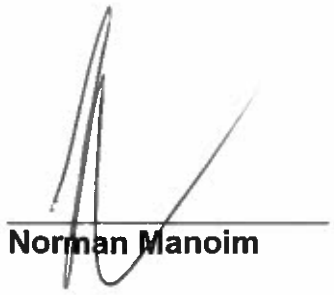
[21] We thus find that the Commission has made out a cause of action on its papers.

CONCLUSION

[22] ZTE SA has failed to persuade us that its objections can be decided by way of exception as they raise disputes of facts which must be resolved at a hearing. Its application for exception is dismissed and we accordingly grant the following order.

ORDER

1. The applicant's exception application is dismissed;
2. There is no order as to costs; and
3. The parties are to approach us for a pre-hearing in order to set-the matter down for trial.



Norman Manoim

07 May 2018
DATE

Enver Daniels and Mondo Mazwai concurring

Tribunal Researcher:	Aneesa Ravat
For the Applicant:	MJ Engelbrecht instructed by Hogan Lovels Inc
For the Commission:	V Notshe SC assisted by KD Magano instructed by KBK Attorneys