

LEGAL DEVELOPMENTS

The impact of the Enterprise Act 2002 on competition regulation has been tested for the first time in the case of the *OFT v IBA Health*. Christopher Vajda QC and Benjamin Lask report on the recent judgment of the Court of Appeal

The new regime

What effect does the Enterprise Act 2002 have on the making of merger references to the Competition Commission? Does it lower the threshold for a reference, with the effect that more mergers must now be referred? And on what basis should the Competition Appeal Tribunal (CAT) exercise its new jurisdiction to review the decisions of the Office of Fair Trading (OFT) whether or not to make such a merger reference? The answers to these questions are to be found in the important judgment of the Court of Appeal handed down on 19 February, 2004, in *OFT v IBA Health* — the first case to consider the new merger control regime that came into force on 20 June, 2003.

Background

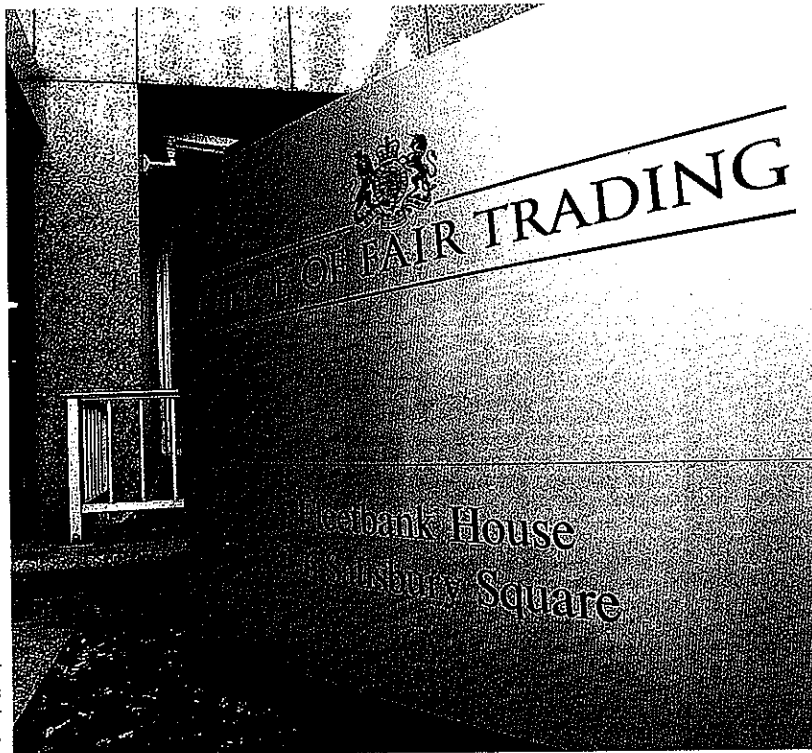
Under the new regime, the OFT replaces the Secretary of State as the body with responsibility for referring mergers to the commission for in-depth investigation. Under s.33(1)(b) of the act, the OFT has a duty to refer a relevant merger situation where it believes that 'it is or may be the case that...the creation of that situation may be expected to result in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services'.

In this case iSoft and Torex, both of whom supplied IT software and systems to the healthcare market, notified their proposed merger to the OFT on 1 August, 2003. The OFT accepted that, in respect of existing IT systems, the merging companies were the two leading suppliers of software to the UK healthcare sector. However, the effect of the merger on competition in the sector had to be viewed in the light of the national programme for IT — a huge new Department of Health programme that altered the future competitive landscape and meant that competitive constraints had to be viewed under a new scenario. On this basis, the OFT decided that the duty to refer under s.33(1) did not arise and accordingly declined to refer the merger to the commission.

Subsequently IBA Health, an Australian producer of healthcare IT systems, applied to the CAT for a review of the OFT's decision under the new power conferred by s.120 of the act. Section 120(4) provides that in determining such an application the CAT shall apply the same principles as would be applied by a court on an application for judicial review. The two key issues before the CAT, and subsequently the Court of Appeal, were the correct interpretation of s.33 of the act and the scope of the CAT's new review function under s.120.

CAT proceedings

The CAT considered that the phrase 'is or may be the case' in the opening part of s.33(1) was critical. The



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inclusion of 'may' indicated that where there was 'room for two views' on the question of whether the merger may be expected to lead to a substantial lessening of competition (SLC), the duty to refer arose. As to whether a merger gave rise to 'room for two views', the CAT formulated a two-limb test. The OFT had to satisfy itself that as far as it was concerned there was no significant prospect of a SLC, and that there was no significant prospect of an alternative view being taken in the context of a fuller investigation by the commission.

The CAT said that it found it difficult to interpret the duty imposed on it by s.120(4), but it proceeded on the basis of a number of propositions. Firstly, the principles to be applied on an application for judicial review varied with the particular context. Secondly, since the CAT was a specialised tribunal, the reasoning of the Administrative Court decisions on the judicial review of regulators was not directly applicable. And thirdly, the CAT asked itself whether it was satisfied that the OFT's decision was not erroneous in law, and was one which it was reasonably open to the OFT to take, giving the word 'reasonably' its ordinary and natural meaning.

In respect of the two-limb test under s.33(1), the

CAT found that the OFT had failed to consider the second limb. Further, the decision failed to set out either the facts upon which it was based or the material the OFT had relied upon. Accordingly, the CAT could not be satisfied that all material considerations had been taken into account, nor that there was material upon which the OFT could reasonably have reached its conclusion. The CAT thus quashed the OFT's decision not to refer and directed that it reconsider the matter.

Court of Appeal proceedings

On appeal by the OFT and the merging parties, the court firmly rejected the CAT's two-limb test. The belief required by s.33(1) in order to trigger the duty to refer was the OFT's belief that the merger may be expected to result in a SLC, not that the commission may in due course reach such a view. The correct test was precisely that stated in s.33(1). The words were ordinary English words and should be applied in accordance with their ordinary meaning. Giving the lead judgment, the vice-chancellor warned against attempts to paraphrase or gloss the words used in the statute. In particular, the OFT's own published interpretation of s.33(1) effectively substituted 'significant prospect' for 'may

and could be criticised as setting the requisite degree of likelihood too high.

Nonetheless he explained that the degree of likelihood required by the word 'may' in the phrase 'is or may be the case' was higher than fanciful but lower than 50%. In between those two extremes the OFT had a wide margin in which to exercise its judgment.

Lord Justice Carnwath agreed with the vice-chancellor and differed from the CAT as to the respective roles of the OFT and the commission. The statutory framework suggested that the formation of a belief in the possibility of SLC by the OFT required more than just a preliminary investigation, and the OFT had more than a purely first-screen role.

As to the scope of the CAT's review function, the vice-chancellor held that s.120(4) imposed upon the CAT a mandatory requirement to apply the ordinary principles of judicial review. However, he declined to criticise the CAT and held that it had neither reversed the burden of proof nor erred in failing to apply the Wednesbury test of unreasonableness.

Lord Justice Carnwath added that the CAT could not discard established administrative case law relating to 'reasonableness' in favour of the ordinary and natural meaning of that word. Moreover this was unnecessary since the ordinary principles of judicial review were flexible enough to be adapted to the particular statutory context.

The court agreed with the CAT on the deficiency of the OFT's reasoning. The latter's conclusions failed to discount the likelihood of a SLC. Further the conclusion that the NPFT altered the future competitive landscape was insufficient to justify the further conclusion that existing anti-competitive features, including the parties' market share (44% and 66% in the relevant markets), were overcome, such as to remove the requisite likelihood of a SLC. Therefore either the OFT had applied too high a test of likelihood when forming its belief as to whether the merger may be expected to result in a SLC, or it failed adequately to justify the belief it formed in accordance with the proper test. Either way, and notwithstanding the mistaken adoption of the two-stage test under s.33(1), the CAT's ultimate conclusion was right and should be upheld.

Despite losing the case, the judgment will have come as a great relief to the OFT and was broadly welcomed by competition specialists. The CAT's two-limb test would have reduced the OFT's role by seriously lowering the threshold for mandatory references to the commission, which are time-consuming, costly and can act as a deterrent to pursuing a merger. At the same time, the Court of Appeal has affirmed that an OFT decision on a merger reference must be properly and adequately reasoned — particularly in a more complex case — otherwise it may be struck down by the CAT.

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