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Abstract

On 3 December 2003, the Competition Appeal Tribunal in the UK upheld an application by IBA Health Ltd for judicial review against the Office of Fair Trading's decision not to refer the anticipated merger between iSoft Plc and Torex Plc to the Competition Commissionfor detailed investigation. This is the first case under the new merger control provisions in the Enterprise Act 2002 to come before the Tribunal for judicial review under Section 120 of that Act.

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On 3 December 2003, the Competition Appeal Tribunal in the UK upheld an application by IBA Health Ltd for judicial review against the Office of Fair Trading's decision not to refer the anticipated merger between iSoft Plc and Torex Plc to the Competition Commission for detailed investigation. This is the first case under the new merger control provisions in the Enterprise Act 2002 to come before the Tribunal for judicial review under Section 120 of that Act.

The judgment of the Competition Appeal Tribunal delimits the role of the Office of Fair Trading in merger review, essentially allowing the Office of Fair Trading to clear only those mergers that raise no "grey" issues. Where there is doubt about whether a merger would result in a substantial lessening competition, the Office of Fair Trading will, following this judgment, have to refer the case to the Competition Commission for investigation.

I. Factual Background and Proceedings before the OFT

On 1 August 2003, the Office of Fair Trading ("OFT") received notification of the anticipated merger between iSoft Plc ("iSoft") and Torex PLC ("Torex"). Both iSoft and Torex are public companies, providing software and systems to hospitals and healthcare providers in the UK. The merger concerned two software applications in particular, Electronic Patient Records (EPRs) and Laboratory Information Management Systems (LIMS).

The OFT found that iSoft and Torex were key suppliers to the secondary healthcare sector of both of these systems. In terms of installed base, the parties would have a combined market share of 44 percent and 56 percent respectively of the supply of EPRs and LIMS. The OFT also found that barriers to entry were high and that there was limited supply-side substitutability.

The merger was taking place against the backdrop of the Government's overhaul of the procurement system for IT within the National Health Service (the National Programme for IT, or NPfIT). The NPfIT applies to future IT procurement projects in England and aims to provide seamless communication in the provision of healthcare services. The NPfIT creates the concept of a Local Service Provider ("LSP"), essentially a project manager working with the strategic health authorities to design, manage, finance and implement the IT deployments. The LSP has the responsibility for nominating Preferred Application Provider(s) ("PAP") with whom it will primarily work. Torex had applied and then withdrawn its application to be a LSP while iSOFT was nominated as a PAP.

On 30 September 2003, the OFT sent an "issues letter" to the parties, setting out nine key potential competition concerns. These concerns centred on the high market share of iSoft/Torex and the loss of direct bidding competition between them. Given the high barriers to entry, one concern was that other providers might not be able to provide a significant competitive constraint to the merged business. Another concern was the uncertainty as to the

likely effect of the NPfIT in terms of future changes to the competitive landscape and the timing of such changes.

The OFT held a meeting with iSoft and Torex on 2 October 2003 and received a detailed submission from iSoft/Torex on 6 October 2003. The decision meeting within the OFT was held on 8 October 2003. However, the clearance decision was not drafted until almost one month later. It was approved by the Chairman of the OFT on 6 November 2003.

In its decision, the OFT concluded that it was not necessary to refer the proposed merger between iSoft and Torex to the Competition Commission ("CC") on the basis that the merger would not, and may not be expected to, lead to a substantial lessening of competition on the relevant market.

The OFT's decision revolved around the positive effect that the NPfIT would have on the market. The OFT had not changed its opinion that iSoft and Torex were the two leading suppliers of IT software to the healthcare sector in the UK. However, it considered that the NPfIT would fundamentally change the future competitive landscape with the effect that the parties' existing strong position would be unlikely, of itself, to confer significant market power on the merged business. In particular, the OFT found that the increased funding available had attracted bids from suppliers outside the UK and that the NPfIT's creation of five LSPs was likely to increase buyer power, as compared to the previous system.

On 21 November 2003, IBA Health Ltd ("IBA") applied to the Competition Appeal Tribunal ("CAT") for judicial review of the OFT's decision. IBA is an Australian provider of IT solutions to the healthcare industry, whose products are sold exclusively through Torex in the UK. IBA had submitted concerns to the OFT during the review procedure, arguing that its links with Torex meant that IBA would not be an effective constraint on the merged business and that the merged business would favour its own products to the detriment of IBA's. Its concerns were not shared by the OFT.

In its appeal, IBA alleged that the OFT had made material errors of law and fact in determining that there was insufficient likelihood of a substantial lessening of competition to oblige a reference to the CC and that it had made material procedural errors by failing to conduct an adequate investigation.

II. The Legal Framework for Merger Review under the Enterprise Act

The Enterprise Act 2002 (the "Act") replaces the merger provisions of the Fair Trading Act 1973 and makes a number of important changes to the UK merger regime. Previously, the decision as to whether or not to make a reference to the CC was vested in the Secretary of State and it was for the Secretary of State to determine what action, if any, to take once the CC had reported its conclusions. The role of the Director General of the OFT was, *inter alia*, to advise the Secretary of State on the making of merger references and, where necessary, to negotiate undertakings in lieu. The Act has changed the roles of the Secretary of State, the CC and the OFT. The Secretary of State now has no role to play (except in very limited circumstances involving national security) and the CC now determines the outcome of the reference and any necessary remedies. As for the OFT, under Section 22 (completed mergers) and Section 33 (anticipated mergers), it has a statutory duty to refer mergers to the CC in certain circumstances. The Act also provides for judicial review by the CAT of decisions in relation to merger references.

Section 33(1) of the Act provides that:

> "The OFT shall, subject to subsections (2) and (3), make a reference to the Commission if the OFT believes that it is or may be the case that … the creation of [a relevant merger] 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".

Where the OFT considers that it is under a duty to make a reference, it may accept undertakings from the merging parties in lieu of making the reference (Section 73). There are a number of criteria to which the OFT must have regard when deciding what undertakings would be appropriate.

The Act creates a duty on the OFT to publish any reference it makes to the CC or any decision not to make such a reference. The OFT must also publish the reasons for its decision (Section 107).

III. The Competition Appeal Tribunal's judgment

The duty to make a reference

The OFT's decision in this case not to make a reference to the CC was not based on any of the exceptions in subsection (2) or on the acceptance of undertakings. Therefore, the CAT's review was concerned with the interpretation that should be given to the wording in Section 33(1).

For Section 33(1) to apply and to create a duty to make a reference to the CC, the CAT held that the OFT must be faced with a real question as to whether the notified merger may be expected to lead to a substantial lessening of competition. In the CAT's view, the iSoft/Torex merger created just such a situation. In particular, the parties' combined market share would be considerably above the 25 percent threshold which the CC (according to its 2003 Guidelines on Merger References) would normally view as sufficient to raise potential concerns regarding the competitive effects of a merger. The CAT was also swayed by the fact that the OFT had set out a number of clear concerns in the "issues letter" it had sent to the parties which it had not thereafter rebutted in its decision clearing the merger.

Having held that the OFT was, in fact, faced with a real question as to whether the iSoft/Torex merger could potentially lead to a substantial lessening of competition, the CAT then turned to the elements of the duty to make a reference under Section 33(1). It examined Section 33(1), which requires a reference to be made "if the OFT believes that it is or may be the case that … the creation of [a relevant merger] situation may be expected to result in a substantial lessening of competition", and broke it down into three elements, namely "the OFT believes", "that it is or may be the case" and "may be expected to result".

The CAT found that "believes" requires a belief on reasonable grounds, i.e. with sufficient supporting material following a sufficient investigation, while "may be expected to result" requires something less than certainty, roughly a more than 50 percent chance. Neither of these phrases were considered by the CAT to pose conceptual difficulties or to be of particular significance to the case at hand.

The phrase “that it is or may be the case”, on the other hand, was considered by the CAT to be central. Essentially, the CAT held that it created a two-step obligation. First, the OFT must reach the view (on reasonable grounds) that the merger may not be expected to result in a substantial lessening of competition. Then, the OFT must assess whether there is an alternative credible view that cannot reasonably be rejected on the basis of a “first screen”. In other words, if the OFT cannot satisfy itself that there is no significant prospect that the CC would take a different view in the context of a fuller investigation, then it must make a reference, even if it itself believes that the proposed merger may not be expected to lead to a substantial lessening of competition. According to the CAT, “the definitive decision maker, in a case where there is room for two views, is not the OFT but the Commission. If there is room for two views, the statutory duty of the OFT is to refer the matter to the Commission, whose duty is to *decide* on the question whether the merger may be expected to lead to a substantial lessening of competition, as section 36(1) expressly requires”.

The CAT took account of the OFT’s own guidance as to the conduct of its proceedings, where it describes its role as a “first-phase screen” and where it states that “the merger control process is designed to allow the OFT to identify those where [substantial lessening of competition] issues may arise, so that they may be examined in greater detail through a reference to the CC”. Additionally, the CAT found that the timescales under the Act precluded anything more than a preliminary investigation at the OFT stage. This is in contrast to a review by the CC, which permits in-depth factual investigation as well as a transparent decision-making process.

The OFT’s review in the case at hand

According to the CAT, the OFT decided not to make a reference to the CC because it believed that the effect of the NPfIT addressed the concern that the parties’ combined market share could lead to a substantial lessening of competition. The CAT therefore examined whether the OFT could reasonably have excluded an alternative view.

In the CAT’s opinion, the OFT’s decision not to refer a horizontal merger between the number 1 and 2 players in the market, with combined market shares in the 45-55 percent range, required a “proper factual basis and exceptional clarity of analysis”. The CAT found that the OFT’s decision did not meet this standard. First, despite coming to the conclusion that a reference was unnecessary only a week after sending the detailed issues letter to the parties, the OFT’s decision contained no detailed rebuttal of the matters highlighted in the issues letter. Secondly, in its pleadings, the OFT recognized that the case left room for differences of opinion. Thirdly, the decision lacked a clear explanation of how the market in question functioned and how the NPfIT would impact the market.

On this basis, the CAT was not satisfied that the OFT had properly examined whether there was an alternative credible view that the proposed merger could lead to a substantial lessening of competition or that the OFT had taken all material considerations into account. The CAT also concluded that the facts underlying the OFT’s reasoning were not sufficiently set out in the OFT’s decision so as to enable it to review whether the OFT's conclusion was properly founded.

IV. Commentary on the CAT's judgment and its future impact

The limited role to be played by the OFT

The judgment of the CAT severely circumscribes the role to be played by the OFT in UK merger review. Broadly, the CAT found that the OFT should attempt to decide complex cases only in exceptional cases and that its role as a "first screen" is not to decide between which factual scenarios it prefers but, where it determines that there is more than one credible scenario, it is required to pass the matter on to the CC for a full investigation and final decision. Accordingly, the OFT can only clear a merger itself at "first screen" stage where there are no "grey" issues.

While it has always been the case that the OFT would recommend to the Secretary of State the reference of mergers giving rise to serious competition concerns (in the absence of any feasible remedies in lieu of such a reference), references to the CC have been relatively rare (generally less than a handful in any year). Although the OFT itself describes its role as being that of a "first screen", the CAT's judgment goes further and essentially turns the OFT into a clearing house, allowed to decide only "open and shut" cases and bound to refer all others to the CC.

Such a position stands in contrast to the role of the European Commission under the EC Merger Regulation, whose duty to carry out a detailed "Phase II" investigation does not arise unless it considers that a proposed merger "raises serious doubts as to its compatibility with the common market". For mergers that do not meet this threshold, clearance can be received at the end of the four week initial review period (equivalent to the period allotted to OFT for its review). Given the recent focus on decentralization and the resulting need for a consistent approach to competition law enforcement across the EU, it is somewhat unfortunate that the UK CAT diverges from the EU approach to such an extent in this area.

For companies planning to merge, the limited role envisaged by the CAT for the OFT in merger review is likely to prove very problematic. Unlike the mandatory requirement to notify mergers of a Community dimension under the EC Merger Regulation, the merger notification system in the UK is voluntary. An unnotified merger cannot be investigated if no steps have been taken to make a reference within a four month period after closing of the merger. Nevertheless, if a reference is made within that four month period, the merging parties are at risk of divestment remedies being ordered should a significant lessening of competition be found. Companies have always had the option of seeking confidential guidance of the OFT as to the likelihood of a reference being made. This route now appears to be jeopardised, as the OFT would only be in a position to give such guidance in clear-cut cases, *i.e.*, those on which companies would not in any event have sought guidance in the first place.

Where the merger raises more complex issues, companies could now either choose to sit out the four month period or notify the transaction in the full anticipation of a lengthy review period. In those circumstances, it would in fact be preferable (were it permitted) to by-pass the OFT and go straight to the CC. Similarly, the CAT's interpretation of the statutory test for reference may inhibit companies from offering, and the OFT from accepting, undertakings in lieu of making a reference. Such undertakings can only be sought where competition issues are identified, *i.e.*, where the test for reference is met. In those circumstances, the OFT may prefer to refer the merger to the CC and companies may also prefer this, given that third parties may successfully argue that, as has been criticised by the CAT, the review period and process before the OFT is inherently inadequate for a full review where "grey" issues have been identified.

The scope of the review undertaken by the CAT

According to Section 120 of the Act, when it reviews an OFT decision not to make a reference, the CAT "shall apply the same principles as would be applied by a court on an application for judicial review". The OFT argued before the CAT that, under established judicial review principles, the review should be confined to a consideration of whether the decision not to make a reference was based on (i) a misunderstanding of law; (ii) a material procedural error; (iii) a material error of fact which was "beyond the bounds of rationality"; or (iv) where the decision was "unreasonable" in the sense that it was "so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it".

In its judgment, the CAT appears to have taken a broad view of its judicial review powers in cases under Section 120. The CAT stated that its review concerned the process undertaken by the OFT, rather than the facts presented by the iSoft/Torex merger. However, it also held that, as a specialized tribunal, it was not bound to defer to the OFT (a specialized decision-maker) in the way that an ordinary tribunal or court would be. As a result, the CAT carried out a fact-intensive review of whether the OFT could reasonably have come to the view that there was no credible alternative to the finding that the merger would not lead to a substantial lessening of competition. Although the CAT did not attempt to rule on the factual issues it raised, the level of detail with which it examined the facts before the OFT is surprising in the context of conventional judicial review in the UK.

The OFT's response

The OFT has applied for leave to appeal the CAT's judgment. The OFT alleges that the CAT incorrectly interpreted the duty to make a reference under Section 33(1) and that it overstepped the boundaries of its powers of review under Section 120. Under Section 120(6) of the Act, an appeal lies only on points of law. It can be anticipated that such points of law would include whether (i) the CAT has correctly identified that Section 33(1) implies a two-limbed test which requires the OFT to satisfy itself that there can be no alternative credible view of the likely effects of the merger; and (ii) whether the grounds of judicial review in competition cases permit the CAT to intervene on the basis that it is not clear from the decision that all material considerations have been taken into account and all material facts established.

Until its appeal is heard, the OFT has indicated that it will abide by the CAT's ruling and has re-commenced its investigation of the merger.

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This Bulletin has been prepared in consultation with Suyong Kim, who will head WCP's London competition practice from January 1, 2004. If you have any questions about the UK merger control system, please do not hesitate to contact her or any of the lawyers listed below.

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