

## Policy note 1/2004

### The Competition Act 1998 and public bodies

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In the light of recent legal developments at UK and EC level,<sup>1</sup> the OFT wishes to share its current thinking on certain circumstances in which a public body engaging in purchasing may or may not be considered to be an undertaking for the purposes of the Competition Act 98 (CA98). In addition, the OFT seeks to give an indication in this note of its likely treatment of such cases, going forward.

In short:

- The OFT is likely to close cases concerning public bodies that are engaged only in purchasing in a particular market and not involved in the direct provision of any goods or services in that market or a related market, on the grounds that such bodies are not undertakings for the purposes of the CA98.
- For the time being, the OFT is unlikely, in the absence of exceptional circumstances, to take forward cases concerning public bodies which are engaged in a mixture of purchasing and direct provision of goods and services for non economic purposes, for example purposes which are purely social, environmental or national security related.

What follows is a brief analysis of recent relevant case law developments and a short explanation of the considerations which have led the OFT to the above policy position.

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<sup>1</sup> Competition Commission Appeal Tribunal (CCAT) judgment in *BetterCare Group Limited v Director General of Fair Trading* (Case 1006/2/1/01), (*BetterCare II*), Court of First Instance (CFI) Decision in *Federacion Nacional de Empresas de Instrumentacion Cientifica, Medicina, Tecnica y Dental (FENIN) v Commission* Case T-319/99 and *AOK Bundesverband*, joined cases C-264/01, C306/01, C-354/01 and C-355/01 judgment of 16 March 2004 (*AOK*).

## Brief legal analysis

- 1 The CA98, which came into effect in March 2000, introduced two prohibitions. The Chapter I prohibition covers agreements between undertakings that may affect trade within the United Kingdom or a part of the United Kingdom and have the object or effect of preventing, restricting or distorting competition in the United Kingdom, or a part of the United Kingdom. The Chapter II prohibition makes unlawful conduct by one or more undertakings which amounts to an abuse of a dominant position in a market if it may affect trade within the United Kingdom, or a part of the United Kingdom. Under section 60 of the CA98, the OFT has to ensure consistency with Community law. Since 1 May 2004, the OFT also applies Articles 81 and 82 of the EC Treaty where an agreement or conduct may affect trade between Member States.<sup>2</sup>
- 2 In European Community competition law the concept of an undertaking covers any entity engaged in an economic activity, regardless of its legal status and the way it is financed.<sup>3</sup> It is the offering of goods and services on a given market that is the characteristic feature of an economic activity.<sup>4</sup> Public sector bodies engaging in economic activities can be undertakings for these purposes.
- 3 BetterCare Group Ltd (BetterCare), a UK provider of residential and nursing home care, complained to the OFT that North and West Belfast Health and Social Services Trust (N&W) (acting as a purchaser of nursing and residential care home services) was abusing its dominant market position in Belfast. The OFT rejected the complaint on the basis that N&W was not an undertaking for the purpose of the CA98.
- 4 On appeal of the OFT's decision by BetterCare, the CCAT decided in *BetterCare II* that N&W was acting as an undertaking, both in the purchasing of services from BetterCare and the direct provision of elderly care by its own statutory homes. The CCAT gave various arguments to support its conclusion that N&W's activities in running its statutory residential homes and engaging in the purchase of social care

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<sup>2</sup> Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the EC Treaty (OJ L1, 4.1.03, p1).

<sup>3</sup> *Hofner and Elser v Macractor GmbH* Case C-41/90 [1991] ECR I-1979.

<sup>4</sup> *Commission v Italy* Case C35/96 [1998] ECR I-3851.

from independent providers are, in the context of the CA98, to be regarded as economic activities for the purpose of deciding whether N&W is an undertaking within the meaning of section 18(1) of the CA98.

- 5 The CCAT remitted the complaint to the OFT for investigation. The OFT subsequently found that N&W's conduct did not constitute an abuse and, therefore, did not breach the CA98 prohibition against abuse of a dominant market position.<sup>5</sup> The OFT did not make a finding as to whether or not N&W was acting as an undertaking for CA98 purposes because the notion of an undertaking in public sector purchasing cases under Community competition law is in a state of development (see cases below).

### ***FENIN v European Commission***

- 6 FENIN is an association of undertakings involved in the marketing of medical goods used in Spanish hospitals. The European Commission (the Commission) had dismissed a complaint by FENIN that various public bodies which were responsible for the management of the Spanish health service (SNS) had abused their position as dominant purchasers of the goods produced by FENIN members. The Commission's grounds for dismissing the complaint were that the public bodies in question did not act as undertakings when they purchased goods from FENIN members.
- 7 The Court of First Instance (CFI) upheld the Commission's decision. It repeated the well established principle that the concept of an undertaking covers 'any entity engaged in economic activity, regardless of its legal status and the way in which it is financed'.<sup>6</sup> In this connection, it stated that the characteristic feature of an economic activity is 'the activity consisting in offering of goods and services on a given market...and not the business of purchasing as such'.<sup>7</sup> Therefore, it went on to say, in deciding whether an activity is economic, it is incorrect to dissociate the activity of purchasing goods from their subsequent use. The nature of the purchasing activity has to be determined according to whether or not the subsequent use of the purchased goods is an economic activity.<sup>8</sup>

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<sup>5</sup> For a summary of the decision see

<http://www.offt.gov.uk/Business/Competition+Act/Decisions/BetterCare+Group+Ltd.htm>

<sup>6</sup> Case T-319/99 *FENIN v Commission* paragraph 35.

<sup>7</sup> *Ibid* paragraph 36.

<sup>8</sup> *Ibid* paragraph 36.

- 8 The CFI considered that where an organisation purchased goods, not for the purpose of offering goods and services as part of an economic activity, but in order to use them in the context of a different activity, such as an activity of a purely social nature, then it does not act as an undertaking simply because it is a purchaser of those goods. This will be the case even if the purchaser buys the goods in question in great quantities or has 'very considerable economic power, even giving rise to a monopsony'.<sup>9</sup>
- 9 FENIN challenged the Commission's approach in following *Poucet & Pistre*<sup>10</sup> (a reference to the European Court of Justice (ECJ) from the French courts) concerning a case where two individuals had refused to pay monthly contributions to compulsory social security schemes which provided old age insurance and the other sickness and maternity insurance. They alleged that both the schemes were abusing a dominant position in requiring compulsory contributions from their members. Both the level of contributions and benefits were determined by public bodies. The ECJ was asked to determine whether the schemes were to be regarded as undertakings under Articles 81 and 82 of the EC Treaty.
- 10 The ECJ held in *Poucet & Pistre* that the schemes were not undertakings because, among other considerations:
- they pursued a social objective in providing cover for scheme members against the risks of sickness, old age, invalidity and maternity regardless of financial status and state of health at the time of joining
  - they embodied the principle of solidarity in that the benefits paid bore no relation to the level of contributions made, and
  - the schemes were entirely non-profit making.<sup>11</sup>
- 11 FENIN argued, among other things, that the principles of solidarity relied upon in *Poucet & Pistre* are not relevant where the activities in question relate to a scheme's dealings with third parties as opposed to its members and the fact that SNS is not profit-making is not relevant because the activity in question, in this case purchasing medical supplies from third parties, was not connected with solidarity.<sup>12</sup>
- 12 The CFI impliedly rejected these arguments when, in deciding that the managers of

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<sup>9</sup> Ibid paragraph 37.

<sup>10</sup> Joined cases C-159/91 and C-160/91 [1993] ECR I-00637.

<sup>11</sup> Ibid paragraph 18.

<sup>12</sup> Case T-319/99 *FENIN v Commission* paragraphs 14,21 and 25.

SNS do not act as undertakings, it took into account the fact that the SNS operates according to the principle of solidarity in that it is funded from social security contributions and other State funding and in that it provides services free of charge to its members on the basis of universal cover.<sup>13</sup>

- 13 The principal differences between the *FENIN* judgment of the CFI and the analysis of the CCAT in *BetterCare II* are:
- The CCAT's reasoning was that, in deciding whether an activity was economic in character, a key consideration was whether an entity is in a position to generate the effects which the competition rules seek to prevent,<sup>14</sup> whereas in the *FENIN* case the CFI held that the characteristic of an economic activity is offering goods and services on a given market and not the business of purchasing, as such. The nature of the purchasing activity has to be determined according to whether or not the subsequent use of the purchased goods amounts to an economic activity.<sup>15</sup>
  - In relation to the application of the principle of solidarity, the CCAT stated that 'any "solidarity" in the sense indicated by the European Court which exists in the present case is at most between the residents and the generality of the taxpayers who fund them, and not between North & West and its independent providers'.<sup>16</sup> The CCAT distinguished the previous cases (including *Poucet & Pistre*) relating to affiliation to sickness funds, pension schemes and insurance schemes on the basis that they were factually distant from the scenario being considered in *BetterCare II*, where 'there is no "scheme" of the kind in issue in the above cases nor "solidarity" between members of a "scheme"'.<sup>17</sup> The *FENIN* case concerned a 'scheme' only in a very general sense, i.e. between taxpayers who funded the SNS via social security contributions and users of the SNS.
- 14 In concentrating on N&W's use of 'business methods' in its purchasing activities, the CCAT appears to have dismissed the elements of solidarity in N&W's funding of care and cost recovery mechanism. The CCAT considered that the principle of solidarity referred to in the case law of the European Court was 'internal' solidarity between members of a scheme and should not apply with respect to external trading partners. The *FENIN* judgment did not suggest that there should be any

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<sup>13</sup> Ibid paragraph 39.

<sup>14</sup> *BetterCare II* paragraph 190.

<sup>15</sup> Case T-319/99 *FENIN v Commission* paragraph 36.

<sup>16</sup> *BetterCare II* paragraph 242.

<sup>17</sup> Ibid paragraph 241.

solidarity in relation to the SNS and its trading partners but that solidarity arises from the SNS being financed by social security and State funding and providing services to all its members free of charge.<sup>18</sup>

- 15 On 14 May 2003 FENIN appealed the CFI's judgment to the ECJ.<sup>19</sup>

### ***AOK Bundesverband***

- 16 The OFT has also considered *AOK*. In Germany, employees are obliged, subject to some exceptions, to be insured by statutory sickness funds. These are independently managed bodies governed by public law principles and possessing legal personality. The benefits provided by the sickness funds are financed through contributions which are determined by the income of the insured and the contribution rate set by each fund.
- 17 The sickness funds do, to a limited extent, compete with one another and with private funds in that the funds set their own contribution levels and compete for the business of those people for whom insurance is voluntary. The funds operate according to the principle of solidarity under which there is an equalisation between funds to remedy any disparity resulting from the degree of risk insured.
- 18 Associations of sickness funds are obliged by law to set maximum fixed amounts which the funds will pay for various medicines and medical products. Although the fixed maximum amount is not imposed as a price for the products in question, in the majority of cases, the price charged is the same as the fixed amount.
- 19 In an Article 234 reference from the German courts, the ECJ was asked to consider whether associations of sickness funds acted as undertakings or associations of undertakings in determining the fixed maximum amounts. The Court decided, contrary to the Advocate General's Opinion of 22 May 2003, that the funds were not undertakings, either in the activity of providing statutory health insurance, or in determining the maximum fixed amounts.
- 20 In answering this question the Court restated the principle from *Hofner & Elser v Macrotron GmbH*<sup>20</sup> that the concept of an undertaking covers any entity engaged in economic activity regardless of legal status or the way in which it is financed. In

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<sup>18</sup> Case T-319/99 *FENIN v Commission* paragraph 39.

<sup>19</sup> Case C-205/03 P, judgment awaited.

*AOK*, the Court considered that the German sickness funds had similar characteristics to the funds at issue in *Poucet and Pistre*.<sup>21</sup> They were involved in the management of the state social security system, they fulfilled an exclusively social function founded on the principle of national solidarity and they were entirely non-profit making. The Court considered that it was of particular relevance that the funds were compelled by law to offer identical benefits which were not dependent on the amounts of contributions. According to the Court, these characteristics meant that the sickness funds were carrying out exclusively social functions rather than economic activities and hence were not acting as undertakings in their principal activity of providing statutory health insurance. This was the case even though there was limited competition between the funds themselves and private funds as described in paragraph 17 above.

- 21 The Court did, however, consider that the funds may carry out activities which were not exclusively social in nature in respect of which they could be undertakings. It therefore went on to consider whether the setting of the fixed maximum amounts was linked to the exclusively social function of providing statutory health insurance so that this activity too should not be considered to be economic. The Court considered that the fact that the funds were obliged by law to set the fixed maximum amounts, and the fact that the procedure for setting the amounts was laid down by law, led the Court to the conclusion that in setting the amounts the funds did not pursue a specific interest which was separate from their function of providing statutory health insurance.

### **Conclusion on undertakings**

- 22 The *FENIN* judgment clearly stated that it is the activity of offering goods and services on a given market which determines whether an activity is economic, not purchasing as such.<sup>22</sup> Following the *FENIN* judgment, it is the OFT's view that, even if an entity is in a position to generate anti-competitive effects, it will not be an undertaking for the purposes of the competition rules if the subsequent related supply of the goods or services (for which the purchases are made) do not themselves constitute economic activities and the entity does not itself directly provide the services. Whatever methods are used in the purchase are not relevant.

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20 C-41/90 [1991] ECR I-1979.

21 Joined cases C-159/91 and C-160/91 - [1993] ECR I-637.

<sup>22</sup> *FENIN v Commission* Case T-319/99 paragraph 36.

- 23 Although the subject matter of the *FENIN* case concerned services provided free to end users, it refers to *Poucet & Pistre* in reaching its conclusion that the SNS operates according to the principle of solidarity. The OFT's view is that the *FENIN* judgment is not restricted to cases where the services provided by the purchaser are free at point of use since this was not the case in *Poucet & Pistre* where members paid monthly contributions towards their cover. This means that if an entity pursues a non economic aim such as purchasing social care in order to provide care for those who cannot fully fund it themselves, i.e. the entity contributes to their care, the OFT will take the view that it is not engaged in economic activity and thus not acting as an undertaking provided that it does not provide these services directly itself. In the *BetterCare II* case for example, without such contribution from the State the vast majority of residents may not have been able to receive any care.
- 24 The CCAT's conclusion in *BetterCare II* that N&W is engaged in an economic activity when it purchases and supplies beds to residents in return for (some amount of) payment (whether the payment is partly self-funded by top-up payments or not and irrespective of the proportion of State funding in each case) contrasts with the *FENIN* judgment in terms of the test for economic activity and how solidarity arises.
- 25 In the absence of *BetterCare II*, the OFT would have taken the view that as a logical extension of the principles in *FENIN*, both the purchasing of social care and the in-house service provided by N&W (namely care in statutory residential care homes) meets the three criteria relied on by the ECJ in *Poucet & Pistre* to establish that the activities carried on by the sickness fund managers were not economic - its in-house provision pursues a social aim, embodies the principle of solidarity and is non-profit making. However, the *FENIN* judgment did not specifically address the situation in which there was in-house provision by the purchasing body in the same market. Further, *FENIN* is appealing the CFI's judgment.
- 26 Similarly observations by the ECJ in *AOK* (that it was of particular relevance that the funds have little influence on the level of benefits to be paid) could suggest an analogy with N&W's lack of influence on the level of care people are provided with, once their needs have been assessed.

### **Bodies that purchase goods or services, but are not engaged in their direct provision**

- 27 Having regard to the above legal position, the OFT considers that generally where a public body is only a purchaser of goods or services in a particular market and is not involved in the direct provision of any goods or services in that market or a related market, that body will not be an undertaking for the purposes of the CA98.

### **Bodies that are engaged in the purchase and direct provision of goods or services**

- 28 The legal position with regard to public bodies which both purchase and directly provide goods or services for non-economic purposes (for example purposes which are purely social, environmental or national security related) is unclear and in a state of development, with the judgment in the FENIN appeal on the subject awaited. The OFT considers that the best use of its resources is to await clarification of the law rather than immediately to examine such cases on an individual basis under the CA98.
- 29 This is not to say that the OFT will not examine markets in which purchasing and provision by a public body for non economic purposes may be causing anti-competitive effects, rather that in circumstances where such cases raise broader issues there may be other more suitable, flexible and effective methods of examining these markets, which deploy the OFT's resources more efficiently. For example, the OFT, following the super-complaint regarding care homes, launched a market study on the subject on 29 June 2004<sup>23</sup> and, as a separate exercise, has commissioned preliminary research into the impact of public sector procurement on competition.<sup>24</sup>
- 30 Accordingly, in the absence of exceptional circumstances, the OFT is unlikely to take such cases forward as CA98 investigations for the time being.

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<sup>23</sup> See [www.offt.gov.uk/Business/Market+studies/Care+homes.htm](http://www.offt.gov.uk/Business/Market+studies/Care+homes.htm)

<sup>24</sup> See [www.offt.gov.uk/Business/Market+studies/procurement.htm](http://www.offt.gov.uk/Business/Market+studies/procurement.htm)