COMPETITION COMMISSION

The UK experience of divestment remedies in market investigations

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Introduction

I am honoured to participate in the Professorentag organized by the BKA and to be among such learned friends. I hope that my speech this morning will provide food for thought; describing divestiture powers and our experience of applying them under the competition regime in the UK.

The nature and origins of divestiture powers in the UK

Divestiture is a power available to the UK Competition Commission (CC) in the context of both merger control[2] and market investigations.[3]

Merger control

Of course, divestiture in merger control is widespread in international practice, including in Germany. The power to order divestiture is of particular relevance in the UK as a consequence of our 'voluntary' system of merger control, under which mergers may be completed without prior notification for clearance. In the event that a completed merger is notified to, or called in by, the Office of Fair Trading (OFT) and is found to create a substantial lessening of competition, the OFT may accept undertakings from the acquiring party to divest parts of the merged business at Phase I[4] or the CC may accept final undertakings[5] or order[6] divestiture following reference for a Phase II investigation.

MIR regime

The UK operates also a market investigation regime (MIR) under which, upon reference from (normally[7]) the OFT,[8] the CC can investigate a given market to see if there are features of the relevant market that prevent, restrict or distort competition and which thereby give rise to an adverse effect on competition (known as an AEC). If such are found, the CC is under a duty to take such action as it considers reasonable and practicable to remedy, mitigate or

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[1]Chairman, UK Competition Commission (CC). All views expressed are personal to the author and do not necessarily represent the views of the CC. The assistance of Adam Land and Trudy Feaster-Gee in the preparation of this paper is gratefully acknowledged.
[2]Section 84(2)(a) and Schedule 8, paragraph 13, of the Enterprise Act 2002 (EA).
[3]Section 161(3)(a) and Schedule 8, paragraph 13, EA.
[4]Section 73 EA – undertakings in lieu of a merger reference.
[5]Section 82 EA – final undertakings on a merger reference.
[6]Section 84 EA – final order on a merger reference.
[7]The sector regulators are also empowered to make market investigation references; most recently Ofcom referred to the CC the market for movies on Pay TV (reference 4 August 2010).
[8]Note that the OFT may accept undertakings in lieu of making a market investigation reference: section 154 EA.

prevent the adverse effect on competition or any detrimental effects on customers.[9] Thus the CC can, and indeed is expected to, intervene directly to address these concerns (subject to control by the courts[10] and a reserve power retained by Ministers to intervene on specific public interest grounds[11]). Among other things, such intervention can lead to the divestiture of assets or businesses through the acceptance of undertakings by the CC[12] or the imposition of an order for divestment.[13]

The MIR is a self-standing legal framework, backed by many years of experience and by robust institutions, enabling whole markets to be examined and their operation improved, as a complement to and in support of the prohibition of anti-competitive agreements and practices.[14]

The concept of a sector or market inquiry is of course fairly widespread. The EU in particular has made considerable use of such powers, most recently in relation to pharmaceuticals.[15] However, if one sets aside the current proposals to introduce similar powers in Germany, the UK regime is unique in giving the CC these direct powers to require divestiture following a market investigation.[16]

Historical context and the role of Ministers

Nonetheless, the power to order divestiture within the UK regime is not new. Nor has it always laid with independent competition authorities.

Until 2003, divestiture was ordered only by Ministers—normally the Secretary of State for Trade and Industry—on the recommendation of the competition authorities (mainly the CC or its predecessor the Monopolies and Mergers Commission (MMC)). This was the case both in merger and market investigations.[17]

Prior to 2003, structural remedies, including divestiture, were occasionally used as a remedy in market investigations. By way of example:

- Following an investigation into the ***Supply of Roadside Advertising Services*** (1981), the MMC recommended that British Posters—a joint venture company operated by ten contractors for sale of roadside poster advertising—be dissolved. This recommendation was accepted by the Secretary of State.

- Following its investigation into the ***Supply of Beer*** (1989), the MMC recommended divestiture of over 20,000 public houses owned by major breweries:

  — At the time, the UK brewing industry was characterized by a high degree of vertical integration. Brewers owned about 75 per cent of public houses in Great Britain and exercised influence over many of the remaining 'free houses' by means of 'loan ties' (eg offering below-cost loans to tenants in exchange for exclusivity of beer supply).

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[9]Section 138 EA – duty to remedy adverse effects.
[10]Section 179 EA – review of decisions.
[11]Sections 139 and 147 EA. The specific grounds are currently defined as national security (section 153 EA).
[12]Section 159 EA – final undertakings on an MIR.
[13]Section 161 EA – final order on an MIR.
[14]Namely the prohibition of restrictive agreements (section 2, Competition Act 1998) and the prohibition of abuse of dominant position (section 18, Competition Act 1998).
[15]On 8 July 2009 the European Commission adopted the Final Report on its competition inquiry into the pharmaceutical sector: see http://ec.europa.eu/competition/sectors/pharmaceuticals/inquiry/index.html.
[16]The powers of the European Commission to order divestment under Article 7 of Regulation 1/2003 relate only to enforcement of the anti-trust provisions set out in Articles 101 and 102 of the Treaty on the Functioning of the European Union.
[17]Under the pre-2003 regime, these investigations were called 'monopoly inquiries'.

- — The MMC found that this pattern of ownership and loan ties restricted competition at all levels of the industry and led to adverse effects including high and rising prices, excessive regional price variations and restriction of consumer choice.

  — The MMC recommended imposition of a ceiling of 2,000 on the number of on-licensed premises, such as public houses and hotels, which any brewing company or group could own. At the time, the MMC estimated that this would require the divestment of some 22,000 premises by UK national brewers.

  — A modified version of this,[18] along with other recommendations,[19] was accepted by the Secretary of State and implemented by means of two Orders (known as the Beer Orders) in December 1989.

  — The impact of the Beer Orders on competition and prices has not been uncontroversial[20] and the industry continues to be the subject of complaint.[21]

- The investigation of ***British Gas*** (BG) in 1993 is an interesting case because the MMC's recommendation to break up the vertically integrated BG was not accepted by the Secretary of State but was later voluntarily implemented by BG itself:

  — BG was both a seller of gas, and owner of the transportation system which its competitors had no alternative but to use. The MMC considered that this dual role gave rise to an inherent conflict of interest which made it impossible to provide the necessary conditions for self-sustaining competition and was expected to reduce the effectiveness of competition in the supply of gas to the non-tariff market, inhibiting choice, restricting innovation and leading to higher levels of gas prices than would otherwise be the case.

  — The MMC recommended divestment of BG's trading activities by no later than 31 March 1997.

  — The Secretary of State did not accept this recommendation but instead brought forward the timescale for introduction of domestic competition to 1998 through the 1995 Gas Act. BG also agreed to put in place 'Chinese walls' between its transportation and supply businesses.

  — In 1997, BG decided unilaterally to split itself up along the lines recommended by the MMC into Transco, which operated the 'natural monopoly' distribution business, and Centrica, which was active in gas production and supply.

This is the market structure which, broadly, persists today and I see echoes of this case in recent developments in the German energy market. [22]

Since the coming into force in 2003 of the Enterprise Act 2002, the CC has been responsible for determining remedies and, as a consequence, the power to *require* rather than *recom-*

[18]In the end, some 10,000 licensed premises were required to be divested.
[19]Such as the elimination of loan ties and requirements to offer a 'guest beer'.
[20]See, for example, the work of Margaret Slade, references to which may be found at www.res.org.uk/society/mediabriefings/pdfs/1998/May/slade.asp.
[21]See most recently OFT Press Release 104/10, where the OFT concludes that the pub sector in the UK is competitive overall and there are insufficient grounds to justify further OFT action in respect of the Campaign for Real Ale super-complaint.
[22]*E.ON* offered to the European Commission in Feb/March 2009 significant commitments to divest both generation capacity and its transmission system business in the German electricity case; a voluntary divestment of *RWE*'s gas transmission network was accepted by the European Commission in March 2009.

mend divestiture has been conferred on the CC.[23] The CC's exercise of its remedies powers is, in all cases, subject to the need to ensure that its remedies are appropriate, effective and proportionate.

I will now describe the CC's practical experience of applying divestiture remedies in the context of the MIR regime.

The CC's experience under the Enterprise Act 2002

The CC is under a statutory duty to achieve as comprehensive a solution as is reasonable or practicable to the AEC and/or resulting harm to consumers[24] and to meet this duty we seek to find an effective solution which is also proportionate.

In considering what remedies would be appropriate in any particular market investigation, we will take as our starting point our diagnosis of the market features that cause the AEC. These features may include the structure of the market concerned, the conduct of suppliers or the conduct of customers. We then consider which of the remedy options open to us are likely to be appropriate. The options that we may consider include structural remedies (eg divestiture), behavioural remedies (eg informational remedies or measures to reduce barriers to switching) and recommendations to government (eg to reduce or remove regulatory barriers to entry).

The extent to which the CC will give active and detailed consideration to divestiture will vary from case to case, depending on the nature of our findings on AEC and considerations of reasonableness and practicability of divestiture. To date, we have required divestiture in only one of the nine completed market investigations—BAA Airports. In the remaining eight cases, we preferred alternative remedies, either because divestiture was inherently unlikely to be effective given the AEC finding, or because we were able to identify other effective remedies that were more proportionate.

BAA Airports

The one case to date in which the CC has identified divestiture as its preferred option was ***BAA Airports*** (2009). Here, the AEC derived, in large part, from common ownership of three London and two Scottish airports by BAA. The CC ordered divestment of two London airports (Gatwick and Stansted) and of *either* Glasgow or Edinburgh Airport in Scotland. Other remedy options were found to be ineffective in addressing the structural aspects of the AEC. BAA voluntarily disposed of Gatwick, the UK's second biggest airport, but this was carried out under the supervision of the CC to ensure that purchasers fulfilled our criteria for suitability. Implementation of further divestitures was the subject of litigation in the CAT[25] and Court of Appeal.[26]

We specified in our report on BAA that suitable purchasers would be independent from BAA and its parent, would possess appropriate expertise and financial resources, and would not

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[23] Other than in certain public interest cases, which the Secretary of State determines: section 147 EA – Remedial action by Secretary of State. Note that the Government explicitly considered retaining some residual role for Ministers in relation to divestiture remedies but decided not to do so following consultation (see paragraphs 6.46 to 6.48 of 'A World Class Competition Regime').

[24] Section 134(6) EA.

[25] *BAA Limited v CC [2009] CAT 35*; the CAT upheld BAA's application on the ground of apparent bias of a member of the Group which decided the reference but rejected BAA's second ground of challenge, concerning the proportionality of the divestiture remedy. The CAT quashed the findings in the CC's report relating to the adverse effect of, and remedies for, BAA's common ownership of airports, and remitted these matters back to the CC for reconsideration by a freshly constituted group of members.

[26] On 13 October 2010, the Court of Appeal upheld the CC's appeal, quashing the decision of the CAT on the point of apparent bias and restoring the decision of the CC: *[2010] EWCA Civ 1097*.

create further competitive concerns as a result of divestiture. The objective of these criteria was to prevent divestiture to an entity that could not compete effectively.

In assessing suitability of Gatwick purchasers we began assessment when bidders started the due diligence stage. This ensured that potential concerns were identified at an early stage and minimised delays in the sale. BAA was able to proceed to negotiations with any purchasers that satisfied our criteria; it was not our function to select the most favourable purchaser. The assessment of suitability was highly involved given the scale and complexity of purchase and funding consortia and we engaged external advisers to assist our in-house staff. BAA finally announced agreement to sell Gatwick to Global Infrastructure Partners for £1.5 billion in October last year.

I fully acknowledge that when the CC requires divestment of assets as in BAA, there is a direct interference with property rights. As described above, the Enterprise Act clearly empowers the CC to impose divestiture in order to remedy competition problems. But even where a public authority acts under clear statutory powers on matters of economic policy, the authority will have to demonstrate that the disposal was a legitimate and proportionate interference with property rights and proportionality is commonly relied on as a ground of challenge to our decisions. It is worth noting that, in the only appeal involving divestiture in a market investigation—**BAA**—the proportionality of the CC's divestiture remedies was *upheld*.

There are a number of reasons for this. In BAA, the vendor was of course able to sell at market value, albeit in a depressed market. The CC took account of market conditions in setting the period of time for divestment and was careful to allow BAA the opportunity to sell assets sequentially. We felt that we struck a sensible balance—introducing diversity of ownership into the airports market, while not putting BAA at an unnecessary disadvantage.

Cases in which the CC has not adopted a divestiture remedy

The remaining eight cases, where we have not adopted a divestiture remedy, can each be thought of as falling into one of the following two scenarios:

- First, divestiture may be ruled out following a detailed consideration of the pros and cons of divestiture and alternative remedy options.

- Secondly, divestiture may be ruled out on the basis of a relatively brief initial consideration as being inherently unlikely to be an appropriate solution to the AEC.

One case where divestiture was ruled out only after a detailed consideration was the ***Supply of Groceries in the UK*** (2008). We considered whether compulsory divestiture of one or more of the multiple stores in a market would be appropriate where retailers had a strong market position in a highly concentrated local market and more than one store in that market. However, we decided not to pursue this remedy. Store divestitures would involve the transfer of ownership of an existing, trading store. In our view, such a transfer could have had a disruptive effect on consumers in the short term (those customers who had chosen to shop at the divested store would have to find an alternative store in order to continue shopping with the same retailer) and divestitures would also have represented a significant intervention in property rights and we did not believe that such an intervention was proportionate to the gravity and prevalence of the AEC we found.[27] Instead we considered that the introduction of the 'competition test'—covering future development—and the controlled land remedies would encourage entry by other retailers and facilitate increased competition.

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[27]It was perhaps ironic that in its appeal against the competition test recommendation (*Tesco PLC v. CC [2009] CAT 6*), Tesco appeared at one stage to be implying that outright divestiture would have been less disproportionate than the test itself.

Similarly, in ***Bulk Domestic Liquid Petroleum Gas*** (***LPG)*** (2006), the OFT put forward a proposal to separate the supply of LPG from the supply of the tank in which the LPG was stored at the customer premises. The CC accepted that separating supply of these two items would address the barriers to switching that gave rise to an AEC but rejected this remedy on grounds of proportionality and effectiveness. The CC's preferred remedy was to put in place a framework for transferring the ownership of LPG tanks from one supplier to another when a customer switched. In our view, this tank transfer remedy was equally effective and less intrusive, commensurate with the need to ensure that the position in one business could not be leveraged into the other business and the need to ensure that responsibility for safety was clearly allocated between the owner of the tank and the supplier of LPG.

In other cases (eg Store Cards (2006), Northern Ireland Banks (2007)), the features that have been identified as giving rise to an AEC did not include market characteristics that indicated a problem with the structure of the market (eg the size and/or number of firms), so the CC did not consider divestiture measures in any great detail. Behavioural remedies, such as requirements to provide specific information to customers, were considered to be equally or more effective and less costly.

So we may see from these examples that although divestiture can be a very appropriate remedy in some situations, it is unlikely that divestiture will be the normal remedy of choice as it is in most merger inquiries.

Undertakings in lieu of reference

The Enterprise Act also enables the OFT and other bodies with powers of reference to adopt divestitures and other structural remedies in lieu of reference to the CC.

Thus, in ***BT/Openreach*** (2005), Ofcom (the sector regulator for telecommunications and broadcasting) accepted undertakings for 'management' separation of Openreach (a new Access Service Division) from the rest of BT in lieu of making a reference to the CC, in expectation that the outcome would be an order for divestiture by the CC. BT Openreach was to provide to third party competitors various services considered critical to effective competition. BT Openreach was to be a functionally separate division of BT, with its own CEO, and its own incentives and reporting structure. Whilst this avoided a divestiture process, it did raise complexities of divisional separation and the specification of the mechanisms to ensure equal access for BT and its competitors.

Divestitures and the banking sector

Before my concluding remarks, I will touch briefly on the debate about whether divestitures are necessary or appropriate in the banking sector. This issue has arisen in various contexts in the UK over the past decade.

Divestiture of bank branches to aid new entry was considered in some depth as a remedy option in the CC's 2002 investigation into the ***Supply of banking services by clearing banks to small and medium-sized enterprises*** (SMEs). The remedy was rejected, in part, because supply of services to SMEs overlapped with personal banking, which was outside the terms of reference. As with the Groceries market investigation, there was also an issue about the extent to which customers' existing relationships with their banks would be disrupted by any divestiture.

More recently, divestiture has been applied as a remedy in the banking sector in the case of **RBS**[28] and of **Lloyds**,[29] where branch disposals were ordered to restore competition under EU State Aid measures.

There is currently a wider debate over 'breaking up' the banks in the UK following the financial crisis of 2008.[30] This debate covers the issues of whether investment banking and retail banking activities should be separated (ie whether the retail banking 'utility' should be insulated from the risks taken in the investment banking 'casino'), whether some financial institutions have become 'too big to fail' (with consequent risks to taxpayers) and whether the financial crisis itself has resulted in an unacceptably high degree of concentration in banking markets. An ad hoc **Independent Commission on Banking (ICB)** has been established[31] under the chairmanship of Sir John Vickers to consider the prudential and competition aspects of banking and bank structures and to make recommendations to Ministers.[32]

Conclusion

May I now offer a few concluding remarks.

The UK competition regime has long allowed for divestiture remedies to be a possible outcome of market as well as merger investigations. Prior to 2002, the power to require divestiture was originally exercised by Ministers and, with some notable exceptions, the power was rarely exercised in the context of a market investigation.

Since 2003, the MIR regime has been relaunched with a *sui generis* legal framework and strict judicial accountability. The CC's remedial powers are clearly specified by statute, as are controls over their use: the remedy must address the AEC that the CC has found and must be as comprehensive as is reasonable and practicable.

In applying this framework, the CC is under a clear duty to ensure that its remedies are both effective and proportionate. The imposition of remedies by the CC has recently been the subject of detailed scrutiny by the CAT in the **Tesco**, **PPI** and **BAA** cases.[33] The result is that the law on ascertainment of costs and benefits and how these may be assessed has been clarified. However, in the one appeal involving divestiture (BAA), the proportionality of the divestiture remedies was upheld.

To conclude, UK divestiture powers and practice must be seen in the context of the market investigation regime which is specifically *not* designed to control abuse of dominance, or to prohibit illegal conduct. Instead the MIR enables a market to be examined to see if competition is weak or ineffective and the CC's remedy powers are intended to make competition more effective, eg by removing barriers to entry, lessening governmental regulation or, occasionally, creating new competitors by the break-up of businesses. In each case, the remedy must address the AEC identified. When applied subject to these controls, and in this specific context, divestiture is a powerful and useful measure to promote competition.

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[28]Restructuring plan of Royal Bank of Scotland, N422/2009; EU Press release IP/09/1915.
[29]Restructuring plan of Lloyds Banking Group, N428/2009; EU Press release IP/09/1728.
[30]See *Too big to fail, but not too big to be unbundled? Investigating the banks—The importance of competition*, Peter Freeman QC, 20 May 2010.
[31]See HM Treasury press release no. 11/10 of 16 June 2010 and: www.hm-treasury.gov.uk/d/banking_commission_terms_of_reference.pdf.
[32]The ICB published an issues statement on 24 September 2010. The ICB, unlike the CC, does not have authority to implement any measures.
[33]*Barclays Bank PLC v. CC [2009] CAT 27*; *Tesco PLC v. CC* (see above); *BAA Limited v. CC* (see above).