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Australian Government
The Treasury

Ministerial Brief

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FOR INFORMATION - Divestiture brief

TO: Assistant Minister for Competition, Charities and Treasury, Assistant Minister for Employment - The Hon Dr Andrew Leigh MP
CC: Treasurer, the Hon Jim Chalmers MP

KEY POINTS

- Your office requested an overview of divestiture powers, including existing examples in the statute, international examples, risks and a summary of previous competition reviews recommendations.
- Divestiture is only available as a remedy in limited cases in Australia: to unwind mergers, to dispose of assets in a foreign investment context, or as a last resort to deal with aggravated cases of abuse of market power in electricity markets.
- The international experience is varied. The US has long had a broader divestiture power Australia it is rarely used, while the EU does not have divestiture powers and is considered one of the most effective competition regulators.
  - Recently there have been renewed calls for an expanded divestiture power to address concerns about market concentration.
  - New Zealand considered but ultimately rejected a proposal to break up its supermarkets as a potential solution to cost of living pressures.
- Any divestiture rules would need to be very carefully designed to avoid unintended economic and legal consequences.
  - Past competition reviews have uniformly agreed that pursuing divestiture as a remedy for a breach of market power provisions carries more risks than benefits.

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CONSULTATION

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ATTACHMENTS

A: Additional Information

ATTACHMENT A – ADDITIONAL INFORMATION

Divestiture in the Australian law

- In the competition law context, generally, references to a "divestiture power" relate to the ACCC being able to seek orders from the Federal Court for divestiture, where the court has made a finding a breach of the law. Accordingly, divestiture orders would only potentially arise after the Federal Court has found a breach of the relevant provisions of the *Competition and Consumer Act 2010* (Cth) (CCA).
  - Divestiture orders available for breaches of Part XICA (electricity industry) and under Part IV (restrictive trade practices) as a remedy for a contravention of section 50, which prohibits acquisitions that would result in a substantial lessening of competition or s50A acquisitions that occur outside of Australia.
- Divestiture orders are not currently available for breaches of the misuse of market power provisions (section 46).
- A similar divestiture or disposal power is available under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA).

<u>Mergers</u>

- Under the CCA, the Federal Court can make divestiture orders for mergers if:
  - upon application by the ACCC or an interested party, the court finds a merger would have the effect of, or be likely to, substantially lessen competition; and/or
  - upon application by the ACCC, the court finds the merger authorisation was granted by the ACCC on the basis of false or misleading information provided to the ACCC.
- Divestiture court orders are limited to the assets specifically acquired in contravention of the merger provisions and must be made within 3 years.
- The Competition Taskforce is focussed on progressing merger reform to promote competition, delivering better outcomes for businesses, consumer and the economy.
  The ACCC will have stronger powers to identify and scrutinise transactions that pose a risk to competition.

<u>Electricity</u>

- Part XICA of the CCA prohibits several forms of misconduct in electricity retail, contract and wholesale markets, and includes a graduated range of remedies and responses up to divestiture to ensure that retailers pass on lower prices to customers.

- A divestiture order is a last resort following advice from the ACCC that a corporation has or continues to substantially lessen competition in the electricity market (section 153ZB).
- The Treasurer must be satisfied the divestiture order should result in a benefit to the public or the benefit is likely to outweigh the detriment (section 153ZA).
- The value of the 'threat' of divestiture must be balanced against the impact its use (if successful) would have on investment, particularly for electricity generation where the up-front costs are substantial and these investments are made on the expectation that costs will be recouped and profits made over a long timeframe.
- The divestiture powers so far have not been used but will be assessed in the statutory review of the legislation which must be established by June 2024.
  - The review will need to consider the extent to which higher price outcomes is a result of predatory firm behaviour, or fundamental competitive market forces to form a view on the appropriateness of retaining the provisions.

Foreign Investment

- Under the FATA, foreign persons may need Treasurer approval to acquire Australian assets. The Treasurer may force disposal under section 69 of the FATA of acquisitions that are contrary to the national interest and are made without prior approval (and where imposing conditions on the acquisition would not mitigate the risk).
- The disposal power is intended to be (and is) used extremely rarely because of the flexibility of conditions that can be imposed and the high compliance with the FATA by investors. It has been important in cases where foreign individuals have purchased multiple residential properties in contravention of the FATA (ie, situations which cannot be managed by conditions and can only be brought into compliance by disposal).

International experience

- The international experience with divestiture powers is that they are used only in very rare cases to deal with entrenched and long standing monopolies and where there are no other ways of addressing any abuse of dominance.

United States

- In the United States, divestiture is available to redress a broader array of anti-competitive conduct than in Australia. It is a remedy used both for merger control and in monopolisation cases. While cases outside a merger context have been rare, divestiture is a remedy that the United States Department of Justice does regard as an important tool. It is likely to seek divestiture if successful in current litigation against Google Inc.

- Examples of divestiture cases in a monopolisation context in the United States are relatively dated.
  - In 1911 Standard Oil was broken up into eight firms after finding that it had restrained trade in deals with railroads, in its control of oil pipelines and by price-gouging small competitors.
  - In 1982 a divestiture remedy broke American Telephone and Telegraph Company into a number of smaller companies.
- More recently, divestiture was also sought by the USDoJ in a case against Microsoft relating to its Internet Explorer. That case did not result in Court ordered remedies in the United States. However action by the European Commission did successfully open the internet browser market up to competition. These cases led to the growth of competing search engine businesses including Google.

<u>United Kingdom</u>

- In the United Kingdom, divestiture is available to address substantially lessening of competition as result of a proposed merger. This is similar to the divestiture powers that are available in Australia under the CCA.
- Divestiture is also a remedy that may be ordered by the Competition Authority following a Market Investigation. An example of the use of the power in this way is the British Airports case.
  - In that case BAA a privatised entity that owned seven of the largest UK airports including Heathrow, Gatwick, Stansted, Edinburgh and Glasgow after a market investigation was in 2009 ordered by the Competition Commission to divest Gatwick, Stansted and one of Edinburgh or Glasgow Airports. A subsequent evaluation of this divestiture found substantial economic benefits flowed from the action of the Competition Commission.

<u>European Union</u>

- The EU does not have broad divestiture powers and is generally considered to be one of the most effective competition regulators, having successfully taken some very significant abuse of dominance cases which have successfully opened up key markets to competition.
  - The EU has unwound mergers, notably on 12 April 2024 the European Commission approved, Illumina's plan to divest GRAIL following the restorative measures requiring Illumina to unwind its completed acquisition of GRAIL, which the European Commission blocked in October 2023.
  - Illumina headquartered in the US, is a global genomics company, which develops, manufactures and commercialises next generation sequencing systems. GRAIL, also headquartered in the US, is a healthcare company developing blood-based cancer tests based on genomic sequencing and data science tools.

New Zealand

- In 2023, the NZ Government released a paper outlining the results of a provisional Cost Benefit Analysis (CBA) on supermarket divestment.
- The paper considered the possible impacts of creating additional competition through grocery retail divestment in response to the increasing costs of living.
  - The NZ Government ultimately decided not to require the supermarkets to divest assets given the potentially complex implementation pathway; adverse impacts on some or all consumers (including in regional areas); the possibility of legal challenges, potential damage to New Zealand's reputation on the international stage and the potential failure of an incumbent or new entrant.
  - Furthermore, continuing work on divestment could potentially reduce investment in the supermarket sector in the short term.

Risks regarding use of divestiture orders/unintended consequences

- While divestiture may seem an appealing option to deal with market concentration there could be unintended consequences that could see consumers worse-off.
  - Where market concentration and scale economies go hand in hand, such as in the vertically integrated supermarket sector, divestiture could require the duplication of logistics and supply chains which could see higher prices and less choice for consumers.
- The trigger for the application of divestiture powers also matters.
  - Uncertainty around whether and when divestiture powers would be used can have a chilling effect on business investment (even if in practice they would only be used rarely).
  - Firms will react to restrictions on their market size or limits on their profit by focussing on the most profitable areas, which could leave regional Australians worse off.
- Dr Emerson in his Interim Report for the Food and Grocery Code of Conduct noted the review did not support a forced divestiture to address market power issues in the supermarket industry.
- While Allans Fels in his inquiry into Price Gouging and Unfair Pricing Practices, recommended "a divestiture power should be introduced into the competition law", the report also noted it would not be appropriate to pursue divestiture of Coles and Woolworths due to a loss of economies of scale.
- Notably on 5 April 2024 the Australian Financial Review covered comments made by the ACCC Chair publicly supporting a divestiture power, noting it would rarely be used.
- Any expansion of divestiture powers would have to factor in the constitutional limitations on acquisition of property which carries implementation risk either that the power is ineffective if used or that it results in the Commonwealth paying compensation.

Findings of previous reviews

- A broader divestiture power has been considered in past competition reviews. The Hilmer (1993), Dawson (2003) and Harper (2015) reviews did not recommend divestiture as a remedy to address market power concerns.

National Competition Policy Review (Hilmer) 1993

- The Hilmer review considered that divestiture is appropriate in merger cases, but was not persuaded that the many disadvantages of providing a general divestiture power are outweighed by the possible advantages.
  - Some submissions to the Hilmer review argued that divestiture should be available as a remedy in cases involving the misuse of market power, arguing that dismembering the firm removes the source of the problem.
  - The arguments made in favour of divestiture at the time are similar to those raised today, that is, divestiture provides a remedy to address a structural problem rather than specific conduct and provides a strong deterrent to firms.
  - It remains the case that a number of difficulties remain in achieving this outcome namely that it is arbitrary which parts of the firm should be divested (in contrast to mergers where it is clear the acquired assets or shares which should be divested).
  - To break up a firm may eliminate economies of scale and/ or generally decrease economic efficiency and the courts are not well placed to manage the inevitable political implications.

Review of the Competition Provisions of the Trade Practices Act (Dawson) 2003

- The Dawson review made similar arguments as Hilmer and reached the same conclusion that it did not favour expanding divestiture beyond unlawful mergers because of the potentially broad nature of such a remedy and difficulties in targeting the conduct of concern.

- The Dawson Review noted divestiture in the context of mergers involves the Court 'unwinding' a transaction rather than splitting a firm that has expanded through organic growth.

  - *A corporation with substantial market power does nothing illegal through the possession of shares and other assets. The prohibited conduct is the taking advantage of that market power. Conceptually divestiture is inappropriate because there is no clear nexus between the assets to be divested and the contravening conduct.*
  - *To identify the specific assets to be divested to preclude a corporation from taking advantage of its market power would be difficult at best and arbitrary at worst.*

- Even if successful, while reducing the size of a firm may limit its ability to misuse its market power, divestiture is likely to have broader impacts on the firm's general efficiency. Such changes could also have negative flow-on effects to consumer welfare. It is also possible that divested parts of a business might be unviable.

  - *Further, it would leave the redesign of a firm or industry in the hands of the court, which is generally not well positioned to make decisions about industry policy.*

Competition Policy review (Harper) 2015

- The Harper Review also concluded that forced divestment would have broader effects on a company's efficiency and could potentially harm consumers. "It is possible that divested parts of a business might be unviable".
- The Harper review noted where section 46 is breached, the court already has a wide range of sanctions including pecuniary penalties that can greatly exceed the benefit the firm has obtained from the conduct.
  - In 2022, the Government substantially increased maximum penalties for breaches of competition and consumer law.