ROUNDTABLE COMMENTARY

Transatlantic Divergence in *GE/Honeywell*: Causes and Lessons

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On May 2, 2001, the Antitrust Division of the U.S. Department of Justice announced that it had reached an agreement in principle with General Electric Company and Honeywell International Inc. that resolved the Division's antitrust concerns with the companies' proposed merger.[1] On May 16, 2001 the Canadian Competition Bureau informed the companies that it would not take any action to challenge their merger. On July 3, 2001, the European Commission announced that it had determined to prohibit the transaction.

In an era of close cooperation and supposed convergence, how did the North American and European antitrust authorities reach diametrically opposed conclusions about the likelihood of anticompetitive effects in a high-profile transaction involving world-wide markets? We see two underlying explanations for this outcome.

First and foremost, the divergence exposed in *GE/Honeywell* is rooted in fundamental substantive and economic differences in doctrine between the United States and EU merger regimes. In particular, *GE/Honeywell* makes clear that EU regulators will invoke "portfolio effects theory" to block conglomerate deals that they fear will cause leading firms to become even more effective competitors. In contrast, in the United States, lower prices resulting from mergers are welcome, even when they are predicted to cause leading firms to gain market share.

Second, the procedures in place in Europe contributed to the ability of the Competition Commissioner to block the proposed merger of GE and Honeywell based on dubious economic grounds and very weak evidence. In particular, the absence of timely and independent judicial review of the Commissioner's decision that a combination is incompatible with the Common Market gives enormous discretion to the Competition Commissioner and to the Commission's Merger Task Force. We discuss below how the interplay of these two trans-Atlantic differences led to the divergent results in *GE/Honeywell*.

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The EU's Conglomerate Case

A key driver of the proposed merger was the desire of GE and Honeywell to combine their complementary product lines in the civil aerospace industry.[2] GE makes, sells, and services large aircraft engines. Honeywell, itself the result of a 1999 merger between Allied Signal and Honeywell, makes small aircraft engines, various avionics components, and other "non-avionics" components, such as environmental control systems, wheels and brakes, and auxiliary power units.

At its heart, the merger was neither horizontal nor vertical, but conglomerate. In fact, the GE/Honeywell merger was remarkably "clean" in terms of horizontal overlaps, given the magnitude of the merger itself and the strong presence of both companies in the civil aerospace industry. Yet the core of the EU's objection to the merger was expressly based on the conglomerate character of the merger. The EU's willingness to block this merger based on conglomerate concerns derives directly from the EU's "portfolio effects" approach, which Assistant Attorney General Charles James recently noted "is antithetical to the goals of antitrust law enforcement."[3]

The EU's conglomerate case is based on the theory that the merged entity will engage in "foreclosure through packaged offers."[4] According to the EU's theory, a combined GE/Honeywell would have the ability and incentive to offer customers attractive discounts encompassing GE's engines and Honeywell's avionics and non-avionics products. As described in the final EU Decision of July 3, 2001, "the merged entity will be able to offer a package of products that has never been put together on the market prior to the merger and that cannot be challenged by any other competitor on its own." EU Final Decision ¶ 350. In particular, the EU was concerned that the merged entity would engage in "mixed bundling, whereby complementary products are sold together at a price which, owing to the discounts that apply across the product range, is lower than the price charged when they are sold separately." *Id.* ¶ 351. The EU was concerned that the discounts offered by the merged entity would be attractive to customers: "As a result of the proposed merger, the merged entity will be able to price its packaged deals in such a way as to induce customers to buy

GE engines and Honeywell . . . products over those of competitors, thus increasing the combined share of GE and Honeywell on both markets." *Id.* ¶ 353. "Airlines generally welcome the financial incentives that come with bundled offers. Given the very nature of their competitive environment, airlines are under great pressure in the short-term to keep their costs under control." *Id.* ¶ 449.

Based on these package discounts, the merger of GE and Honeywell supposedly would strengthen what the Commission viewed as GE's dominant position in aircraft engines for large commercial aircraft and create a dominant position in Honeywell's markets:

> the merged entity's packaged offers will manifest their effects after the merger goes through. Because of their lack of ability to match the bundle offer, these component suppliers will lose market shares to the benefit of the merged entity and experience an immediate damaging profit shrinkage. As a result, the merger is likely to lead to market foreclosure on those existing aircraft platforms and subsequently to the elimination of competition in these areas.

Id. ¶ 355.

The Commission never quantified these effects, and, thus, never specified the degree to which GE's and Honeywell's rivals would be harmed. Adverse effects on customers would allegedly arise because the feared discounts would weaken rivals and ultimately lead to their exit.

GE and Honeywell responded to this theory on several levels: (1) the hypothesized discounting should be regarded as procompetitive; (2) the theory of "mixed bundling" cited in the Statement of Objections was not robust and was based on incorrect assumptions about how engines and other components are selected and purchased in the aircraft industry; (3) the evidence showed that customers typically purchased the relevant products based on their individual merits, as the Commission itself had found eighteen months earlier when it stated that "although packages of avionics and non-avionics have existed, they nevertheless are rare";[5] (4) industry experience showed that companies with broader product lines did not inevitably come to dominate individual product categories; (5) Boeing and Airbus, which did not oppose the merger, were quite capable of implementing procurement policies to protect their own interests and those of their airline customers; and (6) the claim that rivals such as Rolls Royce, Pratt & Whitney, and Rockwell Collins would be weakened and ultimately exit the industry was both contrary to historical and current evidence and in any event purely speculative.

Needless to say, the response to these arguments was dramatically different in Washington and Brussels. Below we describe the nature of the process on both sides of the Atlantic and seek to explain the important differences in practice. Before turning to procedural issues, however, we explore more fully the deep differences in doctrine between the United States and the EU and explain why we believe the EU's approach lacks a sound economic basis.

Economic Divergence: Size, Dominance, Foreclosure, and Efficiencies

Size: Is Big Bad? The EU's Final Decision in the *GE/Honeywell* case is full of examples that seem to rely on GE's success and financial strength relative to its competitors as evidence that the merger was likely to lead to anticompetitive effects. The section entitled "Factors Contributing to GE's Dominance in Engines" leads off with GE Capital, GE's financial arm, and begins with these statements:

> GE is the world's largest company in terms of market capitalization. . . . Indeed, as acknowledged in its own documents, GE is not only a leading industrial conglomerate active in many areas including aerospace and power systems, but also a major financial organization through GE Capital. (¶ 107) In addition to having enormous financial means available in-house, GE's unmatchable balance sheet size offers other major advantages to GE businesses. (¶ 108) GE's financial strength through GE Capital therefore represents a significant competitive advantage over RR [Rolls Royce] and P&W [Pratt & Whitney]. (¶ 110) "In particular, this financial strength allows GE to absorb potential product failure and strategic mistakes." (¶ 110) "GE also uses its financial strength to influence airlines in their purchasing behaviour by injecting capital into their activities at critical times . . ." (¶ 117)

These statements give a good flavor of the EU's reasoning: GE's size and financial strength are a source of GE's dominance in engines and are likely to be used by GE in Honeywell's lines of business as well if the merger were to be consummated.

We agree that GE uses its financial strength to compete more effectively, both by financing internal operations, such as funding R&D and investing in plants and equipment, and by extending financial assistance to customers. In contrast to the EU, however, we view these activities as procompetitive. A company that has the ability "to absorb product failures and strategic mistakes" can invest more heavily in R&D to serve customers. Likewise, "injecting capital into customers' activities" is a form of discounting that benefits customers.

Beyond sheer financial size and strength, the EU expressed concerns based on GE's ability to meet the needs of customers by virtue of its range of operations: "In the aerospace sector, GE offers a unique combination of complementary products and services to customers." (¶ 107) In short, the EU's adverse decision in *GE/Honeywell* was based in part on the fact that GE uses its size and scope to better serve the needs of its customers. We consider such conduct the essence of vigorous competition—providing incentives for customers to purchase GE's products by creatively solving customers' problems.

We read the EU's Final Decision in *GE/Honeywell* to say that the EU may well act to block a firm that is financially strong from expanding into new markets through acquisition if the EU perceives the financial strength of the merged entity to be a source of competitive advantage in the new lines of business. This approach appears dangerously close to the old, discredited "Big is Bad" doctrine from the 1960s. In practice the two cannot be distinguished: Both involve hostility when large, financially strong firms seek to expand into new markets by acquiring significant players in those markets. Both involve hostility towards the use of financial strength to engage in what are unquestionably procompetitive activities, such as offering discounts or attractive financial terms to customers. Both are uncomfortable with firms that take advantage of economies of scope to better serve customers' needs. Neither has a sound economic basis.

Dominance in Bidding Markets. An important building block of the EU's case in *GE/Honeywell* is the assertion that GE has a dominant position in the market for jet engines for large commercial aircraft. The mode of analysis used by the EU to reach this conclusion is sharply different from that adopted in the United States.

There is no dispute that the market for large jet engines is a bidding market: GE, Rolls Royce, and Pratt & Whitney invariably engage in bidding to have their engines selected by customers. In the case of Boeing and Airbus, engine suppliers bid to have their engines accepted on a new aircraft "platform." In the case of airlines, engine suppliers bid to win a particular engine order, very often in situations where multiple brands of engines can be placed on a given model of airplane.

Evaluation of competition in bidding markets is well understood among economists. The fundamental question is whether bidding events are highly competitive or one supplier has a clear advantage. To answer this, economists usually ask a series of questions:[6] (1) Do multiple suppliers typically enter the bidding competition? (2) Do customers consider these suppliers capable of offering good alternatives? (3) Have suppliers historically preserved their strengths and capabilities despite setbacks? (4) Is bidding vigorous? Are there multiple rounds of bidding in which the bids move significantly? Do suppliers offer major concessions to win the bidding? (5) Have multiple suppliers shown the ability actually to win bids with regularity? and (6) Are multiple suppliers positioned technically to remain capable and attractive for upcoming bidding events?

The DOJ and the FTC follow an inquiry roughly along these lines to assess competition in bidding markets. In the *GE/Honeywell* case, the EU did not assess dominance using this approach.[7] Instead, GE was considered dominant because GE had won more engine orders recently than its competitors,[8] often by bidding aggressively. The Final Decision states:

> GE has taken advantage of the importance of financial strength in this industry by relying heavily on discounts on the catalogue price of the engines. These heavy discounting practices actually resulted in moving the break-even point of an engine project further away from the commercial launch of a platform. (¶ 111)

> . . . the merged entity will be able to offer price concessions either on the engine itself or on the other components of its bundle and induce the customer to select the bundle. According to a major European airline, whenever Boeing prices a B737, GE steps in with attractive offers on ancillary engine products and services, spare parts, financial assistance and other GE items in order to convince the airline to go for the GE-powered aircraft. (¶ 391)

In short, the EU can find dominance in a bidding market based on the ability of the firm in question to win bids through aggressive discounting. In contrast, in the United States, dominance would be found in bidding markets when rivals were unable to offer credible, attractive alternatives so that the firm in question was not forced to compete aggressively to win. These are diametrically opposed approaches to the assessment of dominance, or monopoly power, in bidding markets. In our view, the U.S. approach is grounded in solid economics.

Competition Is Foreclosure? A very similar divergence occurs around the concept of "foreclosure." As a matter of economics, we would use the term "foreclosure" to refer to situations where one firm uses its monopoly power to limit the ability of others to compete effectively against it. Classic examples of foreclosure by a firm with monopoly power would be tying and exclusive dealing.

Readers of the EU's final decision in *GE/Honeywell* will find a very different usage of the term "foreclosure." In the EU, a firm that wins by serving customers' needs may be characterized as having "foreclosed" its rivals. For example, the Final Decision states "Indeed, the ability to put together its considerable financial strength . . . and to offer comprehensive packaged solutions to airlines have given GE the ability to *foreclose* competition." ¶ 163 (emphasis added).

The quote provided earlier from the Final Decision (¶ 355) makes the EU's reasoning very clear: the merger will allow GE/Honeywell to make attractive package offers, and "[a]s a result, the merger is likely to lead to market foreclosure on those existing aircraft platforms." We believe this reasoning is both sharply different from that employed in the United States, and deeply flawed as a matter of economics. Rivals that have already developed and sold products on existing platforms naturally are eager to sell more of their products on those platforms. If the merger causes GE/Honeywell to compete more aggressively, rivals might well be forced to lower their own prices (an outcome predicted by the EU). We think the result is enhanced competition on existing platforms. In stark contrast, the EU calls this outcome "market foreclosure" on existing platforms.

The Efficiencies Offense. Perhaps more than anything else, divergence in *GE/Honeywell* can be traced to very different views of what constitute "efficiencies" in mergers.

The U.S. approach and reasoning regarding efficiencies is straightforward and has excellent economic pedigree: (1) Mergers that lead to lower prices are procompetitive. (2) We are most confident predicting the effects of a merger based on the economic incentives that will face the merged entity. (3) Therefore, if combining the assets of the merging firms gives the merged entity an economic incentive to reduce prices that would not otherwise arise, the combination involves merger-specific efficiencies that count in favor of a proposed merger.

The EU took quite a different approach to efficiencies in *GE/Honeywell*. We understand the EU's reasoning to be as follows. (1) "Genuine" efficiencies, such as cost savings, are welcomed and count in favor of the merging parties. (2) However, lower prices that result from "strategic behavior" do not count as "efficiencies" and may be regarded as anticompetitive.

We consider the EU's approach lacking in economic merit. In the United States, cost savings are welcomed precisely because they tend to lead to lower prices. Indeed, this is why reductions in variable costs are treated more favorably than reductions in fixed costs. So long as the cost savings are credible and merger-specific ("cognizable" under the Guidelines), they count in favor of the merger. We see no economic basis for the EU's hostility to price reductions resulting from the combination of complementary products.[9] To the contrary, if one concludes, as did the EU, that combining GE's engines with Honeywell's products will give the merged entity an economic incentive to set lower prices, that should be stronger evidence in favor of the merger than mere cost savings, which may or may not be achieved and passed through to customers.[10]

In the United States, the efficiencies defense is well established in principle (although many would debate its importance in practice): merger-specific reasons why the merged entity will have the incentive to set lower prices can be balanced against any incentives to raise price. Such arguments are routinely offered by merging parties in both horizontal and vertical mergers. Based on *GE/Honeywell*, we must conclude that mergers in the EU may be subject to an *efficiency offense* whereby they are blocked precisely *because* they provide incentives for the merged entity to set lower prices. Under these circumstances, convergence would seem to require either a wholesale rewriting of the efficiencies portion of the Guidelines or a reversal of course by the EU.

Differences in Process and Procedures

In the United States, we firmly believe that GE and Honeywell's arguments against the conglomerate case—and the substantial evidence that supported those arguments—were persuasive. The Antitrust Division carefully explored but then dismissed the theory that competitive harm would arise as a result of package discounting. We are confident that the U.S. process—including such concepts as independence of the decision maker from the investigative process, knowledge of and an opportunity to rebut the evidence arrayed against the transaction, burdens of proof, and the weight to be given to specific types of evidence and economic theories—played a central role in this outcome. From the beginning of the investigation, DOJ staff engaged in an intense and productive dialogue with GE and Honeywell regarding the theory. GE and Honeywell had the opportunity to respond both to DOJ's concerns and to the concerns and allegations communicated to DOJ by others. Economists for DOJ, including a specially retained outside economist, and the parties were closely involved in this process.

Furthermore, had the DOJ sought an injunction barring the transaction based on this theory and these facts, it is very unlikely that the Antitrust Division would have prevailed. Attacking a merger based on fears of discounting would be quite a challenge before an objective and independent court. U.S. courts long ago abandoned the assumption that size alone inevitably leads to a diminution of competition, and would have great difficulty classifying above-cost discounting as anticompetitive. Lack of concern about the deal by large, sophisticated buyers would have been another major problem for any Division case. GE and Honeywell would have been able to observe the assertions made by opponents to the merger and would have been given the opportunity to challenge these assertions and correct factual inaccuracies. In short, with independent judicial oversight, with the conventional rights of defense as one would enjoy before a court, and with some burden on the government to actually establish the likelihood of anticompetitive effects, even the most zealous prosecutors in the United States do not bring cases like this one.

The European Commission faces some of these checks and balances in theory, but in practice was able unilaterally to block the GE/Honeywell merger based on dubious and controversial policy grounds, demonstrably erroneous economic theory, and speculation contrary to the weight of the evidence. That, to us, is one of the central lessons of the *GE/Honeywell* case: how the procedures and practices of the fundamentally *regulatory* EU system enabled the EC unilaterally to block a merger whose effects were admittedly the same worldwide, on grounds that would not pass muster under the *law enforcement* merger review standards in the United States. So long as the theoretical and procedural underpinnings of merger review differ so dramatically in the United States and Europe, and so long as the EU seeks to condemn mergers that it acknowledges are likely to result in lower prices and enhanced competition in the short term, we see no reason why other transactions might not be subjected to a similar divergence among competition authorities.

Below, we offer some suggestions for ways to create greater convergence between merger review processes in the United States and the EU. Unless and until there is greater substantive and process convergence, however, the more immediate question for companies and their antitrust lawyers and economists is how to avoid the fate of the GE/Honeywell transaction. We also attempt, therefore, to identify the lessons practitioners can take away from the GE/Honeywell experience.

Working with United States and EU Competition Officials

As is well known, GE's proposed acquisition of Honeywell was not preceded by months of analysis and negotiation, and, for a variety of reasons, the companies placed a high value on consummating the transaction as quickly as possible. Accordingly, the companies attempted, to the extent possible, to coordinate the required pre-merger filings and interactions with the various competition agencies around the world so that they would be as nearly as possible on the same time schedule.

GE and Honeywell made every effort from the outset to provide competition authorities on both sides of the Atlantic with the same basic information, and to respond quickly to concerns raised by staff in various meetings. The parties met with competition authorities in the United States and EU on consecutive days in early November 2000 to discuss the horizontal and vertical relationships between the companies that they had identified. The HSR filing was made on November 15, 2000. The parties met frequently with the staff of the EU's Merger Task Force (MTF) in November and December 2000, providing voluminous information requested by the MTF staff and an initial draft of the Form CO. The parties waived their confidentiality rights in order to permit the agency staffs to communicate with one another and share information. White Papers and other submissions provided on one side of the Atlantic also were given to the authority on the other side of the Atlantic. It was not until early February 2001, about the same time that the parties went into substantial compliance with the Second Request in the United States, that the MTF staff agreed that the Form CO was complete and could be filed.[11]

As Assistant Attorney General Charles James noted in a recent address to the Canadian Bar Association, there was a "tremendous amount" of coordination among the North American and European staffs investigating the transaction.[12] This was a transaction in which the parties worked to facilitate "convergence and cooperation" and, in the words of Mr. James, "it is hard for me to imagine how [the agencies] could have communicated more."[13]

Despite the frequent communications and access to shared information, the procedural differences between the United States and the EU systems seem to have contributed to the radically divergent analyses and outcomes. These differences—and the strengths and weaknesses of the two systems—flow from the fact that while the Antitrust Division operates in a law enforcement system, the Merger Task Force operates in a regulatory system.

The most fundamental process difference between the U.S. and EU systems is the fact that U.S. authorities must obtain an order from an independent judicial authority prior to blocking a transaction. By contrast, the Competition Commission plays the roles of investigator, prosecutor and judge in each transaction that it reviews. While parties whose transactions have been found by the Commission to be incompatible with the Common Market have the right to appeal that decision to the Court of First Instance of the European Communities, as GE and Honeywell have now done, this right of appeal does not provide the same discipline in the review process as the requirement in the U.S. system that the antitrust agencies obtain a court order enjoining the consummation of the transaction. The right to spend what typically is two years or more appealing a Commission decision to prohibit a merger is not an adequate substitute for the requirement of such an order.[14] There is an essential difference between *ex post* judicial review of a prohibition order—where the parties generally have no practical hope of resurrecting a prohibited merger—and a system where an antitrust authority has to demonstrate likely harm from the merger to a court to obtain an order prohibiting the transaction. Moreover, appeals to the Court of First Instance generally are limited to procedural, rather than substantive or doctrinal, issues. For these reasons, appeals of EU merger prohibitions are rare events—only seven negative merger decisions have ever been appealed.[15]

A second fundamental difference between the U.S. and EU merger control regimes is the type and character of guidance that is provided to parties contemplating a merger. The EU has no counterpart to the U.S. agencies' Horizontal Merger Guidelines. The Competition Directorate's statements on market definition and on remedies do not provide the critical information set out in the Guidelines: What is the analytical framework used by the Commission to determine whether the proposed transaction will affect competition adversely? The consistent application of the Horizontal Merger Guidelines by the U.S. authorities, and the increasing reliance on them by the U.S. courts, provides a transparent set of standards against which to measure proposed transactions. In this case, the parties' and the Antitrust Division's analyses and discussions were informed by the Guidelines and the Division's application of them over the last twenty years. In the EU, a similar kind of transparency could be provided by the requirement of a written decision in merger investigations—a practice which many believe the U.S. authorities ought to adopt. Certainly, those decisions can give some guidance to merging parties. However, our experience in *GE/Honeywell* raises the question whether it is a mistake for United States practitioners to assume that the EU's published merger decisions have a force and effect similar to U.S. court decisions. The analysis of any merger case is highly fact dependent. Our experience in this case was that the EU did not apply its prior decisions in recent cases in the same industry in the way that we would have expected if those decisions had the same precedential character as U.S. court decisions.[16]

A third significant difference between the U.S. and EU regimes is the amount of resources that each has to conduct and supervise its investigations. The U.S. agencies are able to assemble larger teams of lawyers and economists to conduct the intensive factual investigation that is required of a merger between large companies with global reach. The EU's Merger Task Force has far more limited resources, and is compelled—we believe to the detriment of its process—to rely more heavily on the cooperation of customers and competitors of the merging parties.[17] Because all of those providing information and theoretical support to the MTF must be assumed to have mixed motives at best, the need to rely heavily on them presents significant opportunity for mischief.

There is more formal transparency in the EU process, with "checks and balances," such as the Statement of Objections, the public Final Decision, the role of the hearing officer, the opinions of other Commission services, and the Advisory Committee on concentrations. However, this additional "transparency" is more theoretical than practical. Most of the formal procedural safeguards come very late in the process, and in this case were counter-balanced—perhaps as a result of a lack of resources—by far more guarded discussions and interactions with the merging parties at all levels of the Competition Directorate. The Antitrust Division's more informal transparency—where the merging firms and the government investigators and their supervisors engaged in a continuing dialogue to understand and narrow the issues—appears to have contributed to the divergent results in this case. The Antitrust Division was far more forthcoming with its concerns (and those of the third parties with whom we assume it was meeting) than was the MTF.

In addition to the differences in transparency in practice, apparent differences in the concept of burden of proof contributed to the divergent outcomes. Indeed, it is unclear to us that it is possible to have a coherent or consistent notion of burden of proof in a regulatory—as opposed to a law enforcement—merger control regime. Even in the United States law enforcement regime, the merger statutes are an anomaly. Section 7 of the Clayton Act is one of the few statutes that requires those enforcing it to make predictions about the future based on an idiosyncratic event. Nevertheless, in the United States it is clear that the government bears the burden of proving that the proposed transaction is likely to have an adverse effect on competition. That allocation of the burden of proof generally assures that the investigating staff has a healthy degree of skepticism about the concerns expressed, and representations made, by the parties, the parties' competitors, and customers.

In the EU, by contrast, the lack of either merger guidelines that set out a framework for analyzing the effects of proposed mergers or a body of case law with precedential value creates a situation where neither the burden nor the sufficiency of proof is clear. The smaller MTF staff must rely on third parties for its understanding of the facts, and the ultimate decision makers generally learn the facts from the MTF staff, rather than in a dialogue with the parties, who are afforded only limited opportunity to meet with the Competition Commissioner and other senior competition officials. In our experience, the absence of a genuine dialogue about the issues at all levels of the Commission led to elastic concepts of burden and sufficiency of proof.

The differences in the U.S. and EU staffs' understandings of the concept of burden of proof (and the related concept of the weight that should be accorded to certain kinds of evidence) affected the way in which third-party representations were handled. In particular, there was a noticeable difference in the degree to which the U.S. and EU staffs afforded the parties an opportunity to rebut the complaints of competitors. In the United States, without revealing the source of the information, the Antitrust Division staff outlined the concerns that had been expressed by competitors, and the factual basis that was alleged to support the concerns. Those communications provided an opportunity for the parties to investigate those factual bases and to rebut the concerns with specific evidence. In the EU, by contrast, the MTF staff did not ask the parties for information about the same allegations, but rather raised them for the first time in the Statement of Objections, or even later in the process. Thus, allegations that were not a matter of antitrust concern for the U.S. investigators, who had tested both sides of the stories as they knew a reviewing court would do, became critical factual underpinnings for the MTF staff and ultimately the Commission.

Use of Economic Theory and Reasoning

Lack of the need to prove to an independent decision maker that the proposed transaction is more likely than not adversely to affect competition in the future also leads the MTF staff to rely on more speculative economic theories than their counterparts in the United States.

As indicated above, there is no generally accepted theory, much less systematic evidence, predicting that conglomerate mergers will tend to reduce competition or harm customers.[18] Relying heavily on an economic model supplied by a competitor opposing the deal, the Statement of Objections predicted that package discounting by the merged entity would be quantitatively significant and would ultimately lead to the "marginalisation and exit" of rivals. Despite the fact that the underlying data were never disclosed, we believe that the parties' economic experts were able, in written submissions and at the Oral Hearing, effectively to demonstrate that the model was both inaccurate and inapplicable to the civil aerospace industry. Rather than convincing the Commission to drop its conglomerate case, however, the result of this effort was far more limited: in its subsequent written Decision, the Commission, in reasserting its conglomerate case, simply disavowed reliance on any particular economic model.[19] We do not believe that this approach would have been effective in front of an independent fact finder.

We are disappointed by this procedural history, especially since we see adherence to established economic principles on both sides of the Atlantic as the best way to achieve substantive convergence. Commissioner Monti has stated that he seeks to increase the economic component of the Commission's work; if pursued, this initiative should promote convergence. However, we do not believe that the Merger Task Force integrated economic learning into its recommendations in the *GE/Honeywell* case. In the United States, the parties engaged in detailed dialogue with DOJ economists, including the DOJ's outside economic expert; in the EU, there was no such dialogue. To promote convergence, we hope that the Merger Task Force will follow the practice of the Department of Justice and the Federal Trade Commission of having a large, high-quality staff of economists led by a respected, independent economist.

Divergent Outcomes Can Result from Divergent Models of Merger Control

These issues involving economic models and economic experts illustrate a more general point: the formal indicia of transparency, such as the opportunities to respond to the Statement of Objections and to participate in an Oral Hearing, do not obviate the differences in outcome that can result from the fundamental differences in concept between the regulatory and law enforcement models of merger control.

First, the two weeks generally provided to the parties to respond to the Statement of Objections (which coincides with preparation for the oral hearing) is woefully short and comes at a time when the staff's (and perhaps their superiors') views have hardened. This problem is especially marked in situations, such as *GE/Honeywell*, where the Statement of Objections is long and complex, relies on novel theories, and contains factual allegations disputed by the parties. It would be a far better practice for the MTF staff to confront the parties with allegations and concerns about the transaction when they receive them, as the U.S. agencies do.

Improved communications of concerns from the MTF staff to the merging parties would ameliorate a second problem—the apparent lack of interest at more senior levels of the Competition Directorate in the parties' rebuttals of the facts and theories set out in the Statement of Objections. This lack of interest was evidenced in the *GE/Honeywell* case by the failure of those officials to attend and participate actively in the entire oral hearing and by their general reluctance to engage in substantive discussions with the merging parties.

The oral hearing is not intended to, and does not, serve the same function as a preliminary injunction hearing. The Hearing Officer, an employee of the Commission, has limited powers, notwithstanding the recent expansion of his mandate.[20] The Hearing Officer does not rule on the admissibility of, or the weight to be accorded, evidence at the hearing, does not perform the function of a "finder of fact," and does not make a substantive recommendation to the Commission on the basis of the evidence adduced at the hearing. Rather, the hearing, which bears a greater resemblance to a seminar than a trial, serves to educate the Member States and other Commission staffs about the parties' positions. While the hearing does serve an educational function, it does not require that the staff's case be presented in more than cursory fashion and does not afford the merging parties the right to challenge the staff's case directly.

Recommendations for Procedural Reform

While we may be considered impertinent for recommending changes to a merger control system not our own, our experience in the *GE/Honeywell* case and our view that substantive convergence is critical to the legitimacy of all merger control regimes that determine the fate of transactions in worldwide markets lead us to suggest that the following proposed reforms to the EU merger review system are worthy subjects for discussion among academics, practitioners, and merger control authorities:

1. Enhancement of the economic and legal staffs of the Competition Directorate General of the Commission, including the appointment of a chief economist with an independent reputation.
2. Requiring that the MTF staff (as the DOJ and FTC staffs are now required to do) provide detailed guidance to merging parties about the factual and theoretical bases of concern throughout the process. This would include providing the parties with some knowledge of information provided by third parties that is likely to be held against them as the Commission receives it. Partial access to the Commission's investigative file, which in this case occurred during the same two week period that the parties were drafting a written response to the Statement of Objections and preparing for the Oral Hearing, does not provide the parties with a meaningful opportunity to investigate or rebut false or misleading information provided to the Commission by competitors or others whose motives may be at best mixed.
3. Adoption of a set of merger guidelines that would provide businesses and their counselors with guidance about the theories upon which the Commission is likely to rely. At a minimum, the Commission should explain the theory and standards of proof applicable to conglomerate mergers.
4. Clarification of the standard of proof that the Commission requires to determine that a proposed transaction is incompatible with the Common Market, and of who bears the burden of that proof.
5. Expansion of the time permitted for the parties to respond to the Statement of Objections.
6. Consideration of whether it is possible within the EU system to provide a separate, independent mechanism for review of the Competition Directorate's conclusions, or whether there is an effective, pre-prohibition, role that the courts could play.
7. Requiring that the Merger Task Force fully present its case at the Oral Hearing and respond to questions from the merging parties.
8. Affording the parties to a merger the opportunity to present their case to the senior officials of the Competition Directorate and to learn the concerns of those officials prior to the Statement of Objections.

Lessons for Practitioners

As we indicated above, we believe that the combination of a willingness to prohibit conglomerate mergers based on predictions of package discounting and the current procedures and practices of the EU could easily lead to situations similar to GE/Honeywell in the future. Although we do not believe those—perhaps rare—situations are avoidable at present, there are certain steps that practitioners representing merger parties can take to minimize the risk of such an occurrence.[21]

1. Appreciate that, in global transactions concerning global markets, the EU is likely to be the most unpredictable factor—and perhaps the biggest obstacle—to obtaining clearance to consummate a transaction, especially if vertical or conglomerate issues are involved.
2. Anticipate, and be prepared to fully address, economic theories, even if they are novel, highly controversial, or even discredited.
3. Take seriously the very different treatment of efficiencies in the EU and the United States. Merger-specific efficiencies predicted to lead to lower prices can be branded anticompetitive in the EU if enjoyed by a firm that is regarded as large, powerful, or dominant.
4. Provide a comprehensive, well-documented description of the economic structure and functioning of the industry of concern as early as possible in the EU review process.
5. Bear in mind the ability of rivals greatly to influence the EU review process, even when the theories that they are espousing have been rejected by U.S. antitrust agencies.
6. Develop a comprehensive understanding of the likely concerns and positions of all stakeholders in the industry of concern and attempt to address them.
7. Do not underestimate the role of the staff at the Merger Task Force and their ability to drive the result.
8. Make an objective assessment of the likely areas of antitrust concern to the MTF case team, even if you believe concern is unwarranted. If an expeditious review is a central goal of the parties to the transaction, be prepared to offer significantly more to gain approval than you think should truly be necessary to solve the competitive problems identified by the MTF.

Conclusions

In the end, we believe that *GE/Honeywell* stands in part for two propositions.

First, the EU has a fundamentally different view from that of the United States and Canada regarding what constitute procompetitive and anticompetitive effects of mergers. In North America, mergers expected to lead to lower prices are regarded as procompetitive; in the EU, such mergers can be branded anticompetitive based on the fear that added pressure on rivals will ultimately cause them to exit the market. We believe the EU approach is unsound as a matter of competition policy, and that it is more accurately regarded as a form of industrial policy. However one evaluates the EU's approach, the reality is that American as well as European companies engaged in mergers and acquisitions are well advised to bear in mind that merger-specific synergies, helpful as they can be to gain clearance in the United States, may be regarded as a negative in the EU if achieved by a firm that is already strong.

Second, merger control procedures can greatly influence outcomes. Despite all of the efforts at achieving substantive convergence, there are deep, fundamental, differences between merger control regimes based on a regulatory framework and those based on a law enforcement framework that can lead to differences in outcome. We have proposed discussion of various reforms based on our experience in the *GE/Honeywell* case which we believe might help to bridge some of those differences. Under the current EU procedures and practices, merging firms and their counselors need to recognize the very substantial discretion enjoyed by the staff of the EU's Merger Task Force and plan their approach accordingly. ■

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[1] The DOJ agreement required a divestiture concerning military helicopter engines and the authorization of an additional service provider for certain small aircraft engines.

[2] The great majority of the business activity of GE and Honeywell was not at issue in this case. The product lines of concern to the EU account for significantly less than 10% of GE's annual revenues, and about a quarter of Honeywell's revenues.

[3] Charles A. James, Assistant Attorney General for Antitrust, Antitrust Division, U.S. Dep't of Justice, International Antitrust Enforcement in the Bush Administration 4 (Sept. 21, 2001).

[4] *See* Commission Decision, General Electric/Honeywell, Case No. COMP/M.2220 at 84 (July 3, 2001), *available at* http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf [hereinafter EU Final Decision]. We do not directly address in this article the EU's predicate finding that the merger would have created or strengthened GE's allegedly dominant positions in large commercial aircraft engines or engines for large regional jet aircraft. We believe that those conclusions are incorrect as a matter of fact and of law. We note here only that aircraft engine products of GE and Honeywell have never competed for any aircraft application, and that however one characterizes GE's position with respect to aircraft engines, the competition faced by GE would not be diminished by the proposed transaction.

[5] Commission Decision, Allied Signal/Honeywell case, COMP/M.1601 (Dec. 1999).

[6] The specific economic inquiry depends greatly on the frequency of bidding events. Evaluation of competition in a market with dozens of bidding events per year is quite different from evaluation in a market with one major bidding event every few years.

[7] We find it difficult to predict how the EU will analyze bidding markets in future cases because the approach taken by the EU in *GE/Honeywell* was sharply different from the approach taken by the EU itself in previous cases involving bidding markets. In Pirelli/BICC, Case No. Comp/M 1882 (July 19, 2000), the Commission described a true bidding market as one where "tenders take place infrequently, while the value of each individual contract is usually very significant. Contracts are typically awarded to a single successful bidder (so-called 'winner-takes-all' principle). Strong incentives therefore exist for all competitors to bid aggressively for each contract." One week after the GE/Honeywell merger was announced, in Boeing/Hughes, Case No. Comp/M 1879 (Oct. 29, 2000), the Commission noted that the combination of the satellite businesses of Boeing and Hughes would not "create or strengthen a dominant position" because "satellite markets are bidding markets, where the conditions of competition are determined by the presence

of credible alternatives to HSC's products."

8 The bulk of the engine sales attributed to GE were actually made by CFMI, a joint venture between GE and the French firm Snecma. We do not discuss the treatment of CFMI, as distinct from GE, in this article.

9 Of course, we realize that the "strategic incentives" resulting from conglomerate mergers need not all be procompetitive. We accept the principle that restrictions on consumer choice likely to result from a merger of complements, e.g., through tying, could well be anticompetitive. Our discussion here is confined to price reductions resulting from the new incentives facing the merged entity, which was the core of the EU's conglomerate case in *GE/Honeywell*.

10 The EU clearly considers GE/Honeywell's lower prices to be merger-specific. "in the absence of economic integration of competing suppliers, the prices of their bundles cannot be expected to be lower than those of the merged entity. Consequently, the merged entity is likely to attract more customers from its competitors." EU Final Decision ¶ 378.

11 The length of the pre-filing "consultations" with the MTF staff are evidence of the increasing tendency of the MTF staff to obtain additional time beyond the statutory limits by encouraging the parties to delay filing the Form CO while they voluntarily provide significant amounts of information to the staff. This practice is less controllable by the merging parties than the practice of giving extensions of the HSR waiting period to the United States agencies.

12 James, *supra* note 3, at 4.

13 *Id.*

14 Even the recently adopted expedited judicial review process in the EU is likely, when combined with the extensive investigation process, to consume more time than a transaction can be held together.

15 We do not agree with those who suggest that the EU must be more aggressive than the U.S. authorities in blocking mergers because the EU lacks the ability to challenge consummated mergers. As a practical matter, although the U.S. agencies may challenge a consummated merger under Section 7 of the Clayton Act, since enactment of the HSR Act such challenges have been very rare. Moreover, particularly with respect to transactions that are challenged by the EU because of their conglomerate character, the EU would be able subsequently to challenge any abuse of a dominant position that occurred, e.g., through tying.

16 In both the Statement of Objections and the Final Decision the EU broke rather sharply with its own findings in the recent Engine Alliance decision, GEAE/P&W, Case No. IV/36.213/F2 (Sept. 14, 1999), and *AlliedSignal/Honeywell*, Case No. IV/M.1601 (Dec. 1, 1999).

17 In *GE/Honeywell*, for example, the MTF relied heavily on formal economic models submitted by two of GE and Honeywell's rivals. We are not aware that the MTF developed its own economic models in this case.

18 There are two themes to the existing literature on conglomerate mergers: (1) many of them work badly for the merging parties and are later unwound; and (2) they work best when they involve products that are complements in the same industry, rather than unrelated products, in which case established economic theory ("Cournot Complements") predicts that some price reductions can arise from the merger.

19 "The various economic analyses have been subject to theoretical controversy, in particular as far as the economic model of mixed bundling, prepared by one of the third parties, is concerned. However, the Commission does not consider reliance on one or the other model necessary for the conclusion that the packaged deals that the merged entity will be in a position to offer will foreclose competitors from the engines and avionics/non-avionics markets." EU Final Decision ¶ 352.

20 Ironically, those powers were increased just days before the oral hearing in *GE/Honeywell*. Nevertheless, even with the newly increased responsibilities the Hearing Officer performs more the functions of a traffic officer than a judge, issuing Delphic pronouncements that generally favor the position taken by the MTF staff on questions such as the adequacy of access to the investigative file.

21 We refrain from making suggestions for practitioners representing rivals seeking to block mergers that they fear will lead to lower prices and enhanced competition, preferring to leave that task to others.

ROUNDTABLE COMMENTARY

A Bundle of Trouble: The Aftermath of *GE/Honeywell*

BY JOHN DEQ. BRIGGS AND HOWARD ROSENBLATT

LAST JULY, GENERAL ELECTRIC, THE largest corporation in the world, was prevented by the European Commission (EC) from acquiring Honeywell in what would have been one of the largest corporate transactions in history. Instead, it became the largest transaction ever to be stopped, notwithstanding that it had been cleared by the Antitrust Division of the U.S. Department of Justice (DOJ) several weeks earlier. The case generated extraordinary press coverage and controversy at the time,[1] and the controversy has continued as a result of recent exchanges between senior American enforcement officials and senior European officials.

We suggest that the conflict has been overdrawn and that, while there are certainly differences in the two jurisdictions' enabling statutes that yield modest but noticeable differences in law and policy, the case need not cause lasting conflict between the two antitrust regimes. As participants in proceedings on both sides of the Atlantic, we see reasons not to be as concerned. First, we suggest that the factual record before the EC was somewhat different than the factual record before the DOJ. Differences in procedure seem also to have contributed to the different outcomes. In addition, the bases for the EC's ruling and the nature of the arguments made against the transaction have not clearly been put forth on the public record. Fairly understood, the U.S. criticism ("the EC was protecting competitors, not competition") is met not with denial but with confession and avoidance ("we had to protect the small number of competitors so as to preserve competition"). In the end, too, the fact of the spat might well accelerate various forms of convergence.[2]

Apart from some horizontal aspects that could be fixed by divestitures, the merger seemed at first to be a straightforward conglomerate merger with some vertical aspects. The vertical relationship arose primarily out of the fact that General

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