GE/Honeywell: Narrowing, But Not Closing, the Gap

BY WILLIAM KOLASKY

MORE THAN FOUR-AND-A-HALF years after the fact, the European Court of First Instance finally issued its decision reviewing the European Commission's prohibition of General Electric's proposed merger with Honeywell International. That prohibition triggered an unprecedented and extraordinarily direct public scolding from the U.S. antitrust authorities, which had cleared the merger a few months earlier. Charles James, then head of the Antitrust Division, declared that the Commission's "portfolio effects" or "range effects" theories (as they were then called) on which the Commission had principally relied to prohibit the merger were "neither solidly grounded in economic theory nor supported by empirical evidence."[1] James decried those theories as being "antithetical to the goals of sound antitrust enforcement" because they relied on procompetitive efficiencies to prohibit the merger.[2]

These criticisms triggered a remarkable public transatlantic debate between the two competition authorities, in which I was actively involved as the then-international deputy in the Antitrust Division, about the proper objectives of competition policy and the analytical framework that should be applied in evaluating proposed mergers, especially conglomerate mergers between firms that did not directly compete in any relevant market.[3]

This debate led to what we can now see was one of those rare inflection points where the direction of competition policy changed dramatically in a relatively short time, similar to the one that occurred in the United States in the late 1970s. At the time of the decision, the European Commission was growing increasingly aggressive in prohibiting mergers, often on the basis of theories that appeared to have more to do with protecting competitors than with protecting competition. This trend culminated with the Commission's prohibition of the GE/Honeywell merger, followed, a few months later, by its prohibition on similar theories of the Tetra Laval/Sidel merger.[4]

This trend was abruptly reversed when, in the summer and fall of 2002, the European Court of First Instance (CFI) issued three consecutive decisions annulling the Commission's prohibitions of the *Airtours*, *Schneider/LeGrand*, and *Tetra Laval/Sidel* decisions, finding in each case that the Commission had committed manifest errors of assessment and errors of law.[5] These decisions were a serious blow to the stature and reputation of the Commission's Competition Directorate. To its credit, the Competition Directorate, led by Commissioner Mario Monti and his Director General for Competition, Philip Lowe, responded by undertaking a fundamental reform of the Commission's merger control program, over substantial internal resistance. The resulting reforms included disbanding the Merger Task Force and assigning merger review responsibility to the Directorate's industry-specific sections, appointing a Chief Economist supported by a staff of professional economists, introducing peer review panels, and issuing horizontal merger guidelines modeled after the U.S. guidelines.

The effectiveness of these reforms is illustrated by the Commission's recent merger control decisions in cases, such as *Oracle/PeopleSoft* and *Sony/BMG*, in which it reached decisions consistent with those reached in the United States, applying very similar reasoning and with similar reliance on empirical data to support those decisions.[6] The *GE/Honeywell* decision and the high profile transatlantic dispute it engendered were an important catalyst for these reforms.

With this history, the CFI's decision affirming the Commission's prohibition of the GE/Honeywell merger because of horizontal overlaps between GE and Honeywell in three markets is something of an anticlimax. At the time it was imposed, the aspect of the prohibition that attracted widespread attention was the Commission's use of relatively novel theories of conglomerate effects to block what would have been the largest industrial merger in history. While the CFI annuls the portions of the Commission's decision relying on those theories, it does not make any new law but simply applies the standards the CFI developed and the European Court of Justice affirmed in their intervening decisions annulling the Commission's prohibition of the Tetra Laval/Sidel merger. These standards require the Commission to have "convincing evidence" to support the chain of causation by which the Commission believes conglomerate or vertical effects are likely to harm competition.

Curiously, the CFI applied a much laxer standard in reviewing the Commission's evaluation of the horizontal overlaps between the parties. The result is a decision that leaves in place the divergent outcomes on the two sides of the

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Atlantic and that revives concerns as to how effective a check judicial review will be on the Commission's discretion in reviewing horizontal mergers, as opposed to conglomerate and vertical mergers.

The Commission's Decision

At the time of their proposed merger, GE and Honeywell were two of the leading diversified manufacturing companies in the United States and two of the leading suppliers of engines and other components for civilian aircraft. When their merger was announced, most analysts saw the businesses of the two companies as highly complementary, with few, if any, horizontal overlaps. GE was the leading producer of engines for large commercial and regional jet aircraft. Honeywell was a leading producer of engines for smaller regional and corporate jets, but its largest engines had less thrust than GE's smallest engines. In addition, Honeywell was a leading supplier of avionics and non-avionics components, such as radars and radios, for aircraft of all sizes, a business in which GE had no presence.

In July 2001, after the failure of intensive negotiations over potential undertakings to remedy the Commission's concerns, the Commission prohibited the merger, declaring it incompatible with the common market under the standards set forth in the Commission's Merger Regulation.[7] That regulation, as it was then, required the Commission to prohibit any merger that would create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it.

The Commission based its decision on alleged horizontal overlaps in three markets (engines for large regional jet aircraft; engines for corporate jet aircraft; and small marine gas turbines), on vertical foreclosure concerns in the market for engines for large commercial jet aircraft, and on what the Commission called "conglomerate effects" in the markets for avionics and non-avionics products in which Honeywell operated.

The Commission's horizontal and vertical foreclosure concerns attracted little attention at the time of its decision, largely because it was widely perceived at the time that those concerns could have been remedied by relatively limited divestitures. The transatlantic debate over the decision, therefore, focused primarily on the Commission's conglomerate effects theories, which fell into two categories. The first concern was that GE would use the buying power of its aircraft leasing subsidiary, GECAS, to encourage airframe manufacturers to purchase Honeywell's avionics and non-avionics components, just as it allegedly had done to cause them to purchase GE engines, and that this would enable Honeywell to gain a dominant position in its markets, just as GE had allegedly gained a dominant position in the market for jet engines for large commercial and large regional aircraft. The second concern was that GE would bundle Honeywell's avionics and non-avionics products with GE's aircraft engines and would sell the bundled products together on terms that its rivals would not be able to match, and that this would ultimately drive its rivals from the market.

The Court's Decision

The CFI's decision in *GE/Honeywell* initially may appear Solomonic. The court ruled in GE's favor on the Commission's vertical foreclosure and conglomerate effects theories but in favor of the Commission on its horizontal theories. The court therefore gave GE a Pyrrhic victory on conglomerate effects while declining to annul the Commission's prohibition on the ground that the horizontal effects of the merger were sufficient to declare the entire transaction incompatible with the common market. Because the merger was long dead, splitting the baby in this manner had little practical consequence, other than requiring GE to pay the Commission's and intervenors' costs.

Doctrinally, the decision is nevertheless important, not least because the court appears to apply very different standards of review in assessing the Commission's horizontal theories, on the one hand, and its vertical foreclosure and conglomerate effects theories, on the other. As to the latter, the court undertakes a very close review, holding the Commission to the "convincing evidence" standard enunciated in *Tetra Laval*. But as to the former, the court's review of the Commission's horizontal theories is considerably more relaxed.

The dissonance between the two parts of the CFI's decision leaves the divergent outcomes in the United States and Europe unresolved. The U.S. Department of Justice looked at the same facts as the European Commission and yet found none of the horizontal overlaps that the CFI has now held were serious enough to prohibit the entire merger. While the reforms the Commission has implemented since its decision in *GE/Honeywell* may render the decision a historic artifact, the importance of applying consistent standards on both sides of the Atlantic requires that we take a hard look at the court's reasoning to see whether it had a sound basis for sustaining these divergent outcomes.

Vertical Foreclosure and Conglomerate Effects

In reviewing the Commission's vertical foreclosure and conglomerate effects theories, the CFI did not break any new ground, but simply applied the standards that it developed, and the European Court of Justice approved, for reviewing similar theories of indirect anticompetitive effects in *Tetra Laval*.[8]

The* Tetra Laval *Decision. In October 2001, three months after its GE/Honeywell prohibition, the Commission prohibited the proposed acquisition by Tetra Laval BV of the French company Sidel S.A., relying on similar theories of conglomerate effects. Tetra Laval, through its Tetra Pak business, was the leading manufacturer of aseptic and non-aseptic carton packaging and carton packaging equipment, and Sidel was the market leader in PET packaging equipment for making plastic bottles. The Commission argued that the merged firm would be able to leverage its existing dominant position in aseptic carton packaging to create a dominant position in the PET packaging equipment market through practices such as tying or bundling. In addition, the Commission asserted that the merged firm could use these same practices to strengthen Tetra Laval's dominant position in aseptic carton packaging and packaging equipment.

In a landmark decision, the CFI annulled the Commission's prohibition in October 2002.[9] While accepting that conglomerate mergers "may have anticompetitive effects in certain cases," the CFI held that because the effects of conglomerate mergers are generally considered to be neutral or even beneficial and because a finding of anticompetitive effects requires a prediction as to the parties' future conduct, the proof of anticompetitive effects in such cases "calls for a precise examination, supported by convincing evidence."[10] The court emphasized that the Commission must show that the merged firm would have not only the ability to engage in anticompetitive conduct but also the incentive to do so, and that the feared conduct would create or strengthen a dominant position "in the relatively near future."[11] In addition, the CFI held that in evaluating whether the merged firm would have an incentive to engage in anticompetitive conduct, the Commission "must also consider the extent to which those incentives would be reduced, or even eliminated, owing to the illegality of the conduct in question, the likelihood of its detection . . . and the financial penalties which would ensue."[12]

Applying these standards, the CFI found that the Commission had committed manifest errors of assessment in finding that the merger of Tetra Laval and Sidel would create or strengthen a dominant position in any market. In particular, it held that the Commission did not adequately take into account Tetra Laval's existing obligations from the *Tetra Pak II* case not to engage in predatory or discriminatory pricing and tying. The court also found that because PET is considerably more expensive than cartons and there was evidence that customers would consider switching only if the prices of cartons increased by 20 percent or more, the Commission had failed to show that the merger would give Tetra Laval an incentive to bundle PET and carton equipment and to offer lower prices on the bundle.

The European Court of Justice subsequently dismissed the Commission's appeal of the CFI's decision.[13] In an important victory for effective judicial review, the ECJ held that the CFI was entitled to examine "not only . . . whether the evidence relied on is factually accurate, reliable and consistent, but also whether that evidence contains all the information that must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it." The ECJ also expressly endorsed the standards the CFI had applied in reviewing the Commission's conglomerate effects theories and its requirement that those theories must be supported by "convincing evidence" in order to support a prohibition.

***The Court's Application of the* Tetra Laval *Standard in* GE/Honeywell.** The Commission's vertical foreclosure and conglomerate effects theories in GE/Honeywell both depended critically on its finding that GE was already dominant in the market for engines for large commercial jet aircraft and that GE had achieved that position of dominance in part through the GE-only purchasing policies of its aircraft leasing subsidiary, GECAS, and the financial strength of GE Capital. The Commission found that GE would be able to use those same "levers" to achieve dominance in the markets in which Honeywell sold avionics and non-avionics products, in which Honeywell already had a leading, but not dominant, position. In addition, the Commission found that GE's acquisition of Honeywell's engine starter business would strengthen GE's dominance in the market for engines for large commercial jet aircraft through vertical foreclosure by denying competing engine-makers access to those starters at reasonable prices.

The court sustained the Commission's finding that GE was dominant in the market for engines for large commercial jet aircraft but concluded that the Commission had made manifest errors of assessment in finding that the merger would strengthen GE's existing dominant position in that market or create a dominant position in the markets in which Honeywell operated. The court's affirmance of the Commission's finding of dominance lends credence to the view that the threshold for dominance in Europe is lower than the threshold for monopolization (or even attempted monopolization) in the United States and that the two jurisdictions still apply very different methodologies in determining dominance. By contrast, the court's rejection of the Commission's finding of anticompetitive conglomerate and vertical effects from the merger should help to allay the concerns on this side of the Atlantic about the potentially far-reaching implications of the Commission's use of those theories in this case.

1. GE's dominance in the market for large commercial jet aircraft engines. In affirming the Commission's finding that GE had a dominant position in the market for large commercial jet aircraft engines, the CFI relied almost exclusively on structural evidence, finding that GE's 52 percent share of the installed base of engines on large commercial aircraft still in production and its 65 percent share of order backlogs for engines for aircraft currently in production were sufficient to give rise to a presumption of dominance. This finding depends critically on the court's determination that the Commission was justified in attributing the sales of engines manufactured by CFMI, GE's 50-50 joint venture with Snecma, to GE for this purpose. The court held that evidence showing that GE continued to face competition from Rolls Royce and Pratt & Whitney, that it sometimes lost competitions to them, and that it had to offer discounts in order to win certain bids "does not, in this context, preclude it from having a dominant position."[14]

Viewed from the perspective of the U.S. antitrust laws, this holding is perplexing. The definition of dominance under EU law is "a position of economic strength which enables [an undertaking] to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, its customers and, ultimately, consumers."[15] On its face, this definition appears substantially identical to the definition of monopoly power under U.S. law: "the power to control price or exclude competition."[16]

Under U.S. law, at least since Judge Learned Hand's seminal opinion in *Alcoa*, it has been accepted wisdom that while a 90 percent share is sufficient to give a firm monopoly power, "it is doubtful whether sixty or sixty-four per cent would be enough."[17] The facts of the *GE/Honeywell* case, as described by the CFI itself, show why a firm like GE, with only a 52 percent or even 65 percent share of a relevant market, cannot behave "independently of its competitors, customers, and, ultimately, consumers," to the degree that should be required to support a finding of dominance. The CFI acknowledged, for example, that for aircraft not yet in service—that is, those aircraft for which the engine competition is most likely to reflect the current strength of the rivals' respective offerings—Rolls Royce has won 40 percent of orders, with GE winning only 38 percent.[18] The facts recited by the court further show that a substantial part of GE's large share overall is due to its having been selected, more than a decade ago, as the exclusive engine supplier for one hugely successful airframe, the Boeing 737.[19] How, one wonders, can a firm be dominant, when it must discount deeply to win bids and is still outsold by one of its rivals?

Another troubling aspect of this part of the CFI's decision is its acceptance of the Commission's argument that GE had used the financial strength of GE Capital and the GE-only procurement policy of its aircraft leasing subsidiary, GECAS, to achieve its dominant position in the market for engines for large commercial aircraft. The court acknowledged that the empirical data showed that "although the engines purchased by GECAS contributed to some degree to the increase in GE's installed base of engines," and "although that contribution appears to be becoming increasingly significant, it remains minimal."[20] But the court held that this did not necessarily establish that GECAS did not have "a significant impact on the relative strengths of the players," citing a handful of instances in which GE had successfully sought to exploit "the commercial opportunities arising from GECAS activity and from the financial strength of GE Capital in order to promote its engines."[21]

This conclusion raises concern for two reasons. First, it is an example of the CFI allowing a few isolated anecdotes to trump the empirical data, a theme that also pervades its discussion of the putative horizontal overlaps between the two companies. Second, the court seems to allow the Commission to treat what appear to a U.S. eye as fair sources of competitive advantage, given GECAS's small share of the market for aircraft, as being akin to exclusionary conduct.

2. The Commission's vertical foreclosure story. The Commission's vertical foreclosure story was based on Honeywell's position as the only merchant supplier of engine starters for jet engines for large commercial aircraft. (Pratt & Whitney also manufactured starters, but only for its own engines.) The Commission hypothesized that, post-merger, GE would be able to foreclose Rolls Royce from the engine market by either refusing to supply starters for Rolls Royce engines or by offering them only on prohibitively discriminatory terms.[22]

Since these alleged anticompetitive effects hinged on the merged entity's future behavior, the court held that under *Tetra Laval* "the onus was thus on the Commission to produce convincing evidence as to the likelihood of that behaviour."[23] If the conduct alleged would constitute an abuse of dominance under Article 82, this would require, as the court had previously held in *Tetra Laval*, that the Commission examine whether Article 82 would be effective in deterring such conduct. Examining the facts of the case before it, the court found that because the cost of starters was tiny relative to the cost of engines, GE would either have to refuse completely to supply starters for use in Roll Royce engines or would have to impose a price increase "so large that it would clearly amount to abuse."[24] In either case, the conduct would appear to be so easily detectable that Article 82 would likely deter such conduct, as would the additional risk that the conduct would alienate GE's airframe and airline customers. The court held, therefore, that the Commission had committed an error of law in failing to take into account the deterrent effect these factors might have on the behavior of the merged entity.

3. The Commission's conglomerate effects story. The Commission's conglomerate effects story had two basic elements. The first was that GE's financial strength and vertical integration into aircraft leasing gave it a decisive competitive advantage, which had helped it achieve a dominant position in the market for aircraft engines and which it would be able to apply likewise in the markets for avionics and non-avionics products supplied by Honeywell. The second was that GE would be able to gain a further competitive advantage by bundling its engines with Honeywell's avionics and non-avionics products. Together, the Commission found, these competitive advantages would enable the merged entity to extend GE's dominant position with respect to engines into the markets for avionics and non-avionics products in which Honeywell operated.[25]

It was this conglomerate effects story that engendered the greatest concern on this side of the Atlantic. In the United States, we generally believe that it is antithetical to sound competition policy to prohibit a merger because it would make the merged firm a stronger competitor.[26] As the Supreme Court observed in its decision in *Cargill, Inc. v. Montfort of Colorado, Inc.*, "[I]t is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition," whatever the source of their competitive advantage.[27] This is because, as former Treasury Secretary Lawrence Summers has explained, competition is a means to an end, and not an end in itself: "The goal is efficiency, not competition."[28] To the extent that GE's financial strength and vertical integration made it a stronger, more efficient competitor, it would harm consumers to deny them the benefits of those efficiencies out of speculative concern that GE's rivals might not be able to match those efficiencies and might thereby, at some unknown point in the future, be driven from the market. Similarly, to the extent that GE, because it sold complementary products, might have an incentive to offer those products at lower (but still above-cost) prices than a non-integrated supplier of a single product would, consumers again should not be deprived of the benefits of those lower prices out of speculative concerns that less efficient rivals might not be able to match them.

It is disappointing, then, that the CFI in *GE/Honeywell*, as in *Tetra Laval*, appears to accept that, in theory at least, the types of "conglomerate effects" hypothesized by the Commission may "in some cases" produce "anti-competitive effects." While theoretically there may be some chain of causation in which consumers may ultimately be worse off if a firm, by becoming more efficient, is able to drive its rivals out of the market and then raise prices above their pre-merger levels,[29] predicting that outcome with the requisite degree of certainty requires a far greater ability to predict the future than any competition authority or court is ever likely to possess. For that reason, the risk of false positives is high and the cost of those errors (in terms of depriving consumers of lower prices in the near-term) is so great as to make the game not worth the candle. As the Supreme Court explained in *Trinko*, in applying the antitrust laws a court "must weigh a realistic assessment of its costs" against the benefits of antitrust intervention, recognizing that because both the "means of illicit exclusion" and "the means of legitimate competition" are "myriad," mistaken inferences, especially false condemnations, "are especially costly as they may chill the very conduct the antitrust laws are designed to protect."[30]

That said, the standard that the CFI adopted in *Tetra Laval* and applied in *GE/Honeywell* for finding that conglomerate effects are likely to produce anticompetitive results is so stringent that there may be no practical difference between that standard and a rule that disallows conglomerate effects as a basis for prohibiting a merger altogether. That standard allows the Commission to find a merger incompatible with the common market based on "a prospective analysis of the effects of a conglomerate-type concentration," only if it is "able to conclude that by reason of the conglomerate effects a dominant position would, *in all likelihood*, be created or strengthened *in the relatively near future* and would lead to effective competition on the market being significantly impeded as a result of the concentration."[31]

Because "the chains of cause and effect following a merger may be dimly discernible, uncertain and difficult to establish," the court further held that "the Commission had the onus to provide *convincing* evidence to support its conclusion that the merged entity would *probably* behave in the way foreseen."[32] This requires that the Commission show not only that the merged entity will have the ability to engage in the conduct alleged, but also that it would be likely to engage in this conduct. To make this showing the Commission must either have evidence, in the form of internal documents and otherwise, that the merged firm intends to engage in that conduct or, absent such evidence, that the merged entity would have "objective incentives" to do so.[33] Evaluating these incentives requires that the Commission look not only at the incentives to adopt such conduct, but also at "the factors liable to reduce, or even eliminate, those incentives, including the possibility that the conduct is unlawful."[34] If so, the Commission must further consider "the likelihood of detection, the action [likely to be] taken by competent authorities, both at the community and national level, and the financial penalties that would ensue."[35] Finally, if the Commission does find that the merged entity would be likely to engage in the feared conduct, taking into account all these factors, it must then examine the objective market conditions to determine whether that conduct is likely to create or strengthen a dominant position and, if so, in what time frame.

The mere recitation of the conditions that the Commission must meet to prohibit a merger based on conglomerate effects is enough to show how rarely those conditions are likely to be satisfied. In *GE/Honeywell* itself, the court concluded that the Commission's analysis and the evidence on which it relied fell well short of what is required, and that the Commission, therefore, committed errors of law and manifest errors of assessment in relying on the merger's conglomerate effects to find it incompatible with the common market.

• ***Financial strength and vertical integration.*** With respect to the first leg of the Commission's conglomerate effects story—GE's financial strength and vertical integration into aircraft leasing—the CFI held that because the Commission had failed to put forward any evidence that GE intended to transpose these practices from the market for large commercial jet aircraft engines to the markets for avionics and non-avionics products after the merger, the Commission needed to consider whether it would have been in the merged entity's commercial interests to do so. This required the Commission to examine whether "the revenues which the merged entity was likely to derive from those practices would have offset the potential cost."[36] As the Commission had failed to undertake any economic studies comparing these costs and revenues, the court held that it had no basis to find that GE's practices would have been extended to Honeywell's markets.[37]

The CFI found, in addition, that while the Commission had treated each avionic and non-avionic product as a distinct market, it had failed to undertake any analysis of each market individually to see whether, even if the feared conduct were so extended, it would result in creating or strengthening a dominant position on any of those markets, "let alone on those markets as a whole."[38] The court concluded, therefore, that the Commission had "made a manifest error of assessment in holding that the financial strength and vertical integration of the merged entity would bring the creation or strengthening of a dominant position on the markets for avionics or non-avionic products."[39]

• ***Bundling.*** The CFI found the Commission's analysis and evidence in support of its second form of allegedly anticompetitive conduct—bundling—equally deficient. The court began by noting that since GE's share of engines for small regional and corporate aircraft is small, the only engine market in which bundling attributable to the merger could be a concern is the market for engines for large commercial jet aircraft. With respect to such aircraft, the court detected a fundamental, practical problem with the Commission's bundling theory: the final customer for the various engines, avionics products, and non-avionic products is often not the same, thereby making bundling impossible except in those cases where the customer for each product was the same. Even in those cases, bundling would often be impractical because the source selection for engines is often made at a different design stage than for avionics and non-avionics. For these reasons, even without reaching whether the merged entity would have an incentive to engage in bundling, the court concluded that the Commission had failed to show that the merged entity would even have the ability to bundle.

This left the CFI to consider the Commission's argument that bundling would enable Honeywell to convert its leading positions in the markets for avionics and non-avionics components into a dominant position. In making this argument, the Commission had hypothesized three distinct types of bundling: "pure bundling," which the Commission defined as a mandatory tie; "technical bundling," involving the physical integration of products; and "mixed bundling," which the Commission defined as offering a discount on the bundled products if purchased together.

The court rejected the first theory because pure bundling would violate Articles 81 and 82, and the Commission had failed to consider the deterrent effect of its illegality.[40] The court rejected technical bundling as a theory of competitive harm because the Commission had failed to undertake any detailed analysis of what technical integration might be possible.[41] Finally, the court rejected the Commission's mixed bundling theory because, given that the price of an engine is markedly higher than that of each avionics or non-avionics component, it could not be assumed that bundling engines with those other components would have been viable and commercially advantageous for the merged entity following the merger.[42] In addition, the court also found that the Commission had failed to carry out any detailed analysis as to what impact mixed bundling would have on each individual market for the various avionics and non-avionics components in which Honeywell competed. As the court noted, such an analysis would have to examine not only the size of the price cuts and the shifts in sales that would be expected, but also the costs and the profit margins of the various market participants.[43] The Commission undertook no such analysis. The obligation to undertake a detailed analysis could be excused, the CFI held, only if the Commission had "put forward other evidence, such as internal documents, suggesting that the merged entity would make the strategic decision to sacrifice profits in the short term with a view to reaping larger profits in the future," but the Commission "did not put forward any evidence of such a nature."[44]

The CFI's decision, in short, rejects the Commission's conglomerate effects theories across-the-board. The decision highlights how weak the Commission's case was, and it fully vindicates the criticisms of the Commission's reasoning expressed at the time.

Horizontal Overlaps

In prohibiting their proposed merger, the Commission identified three horizontal overlaps between GE and Honeywell. The first two relate to the markets for engines for large regional jet aircraft and commercial jets. The third relates to the market for small marine turbine generators. The Commission found that the proposed merger would either create or strengthen a dominant position in each of the three markets, based purely on the market shares of the combined entity. In affirming the Commission's determination in all three markets, the CFI undertook a review that was far more cursory than its review of the Commission's vertical foreclosure and conglomerate effects theories. The U.S. Department of Justice, by contrast, did not find any lessening of competition in any of these three markets. By affirming the Commission's decision with respect to these markets, the court leaves in place the divergent outcomes on the two sides of the Atlantic. It is important, therefore, to examine the court's reasoning to see what it teaches about the treatment of similar horizontal overlaps in future mergers.

1. Engines for large regional jet aircraft. As both the Commission and the CFI acknowledged, there is no direct horizontal competition between the engines GE and Honeywell manufacture for use in regional jet aircraft. GE's engines are "far more powerful, heavier and more complex than Honeywell's engines," and they do not compete for placement on the same aircraft platforms.[45] The sole basis for the Commission's treatment of these engines as being in the same market is what the Commission called "indirect 'second level' substitutability"—namely, that some purchasers of the BAe Avro, which is powered by four Honeywell engines, might purchase other aircraft powered by GE engines as an alternative to the Avro.[46]

In holding that the Commission did not commit an error of law or a manifest error of assessment in defining the market on the basis of this theory of indirect, second level substitutability, the CFI relied on two types of evidence cited by the Commission. The first were three internal GE documents that purportedly showed that, even though there was no choice as to the engine for a particular platform, there was still scope for an engine manufacturer to discount the price of the engine or associated aftermarket services with a view to promoting sales of the platform/engine package. The second were a press release from BAe and a series of short articles in a trade publication showing that BAe was seeking to market a new version of the Avro, the RJX, as an alternative to regional jets powered by GE engines and that one European airline was considering the Avro RJS, along with three GE-powered regional jets, in an ongoing competition.

The weakness of the evidence the CFI found sufficient to sustain the Commission's novel approach to market definition in this instance is disquieting, especially in light of the U.S. courts' repeated rejection of the market definitions proffered by the U.S. antitrust agencies in a series of recent unsuccessful merger challenges.[47] Neither the Commission nor the CFI made any effort to apply the hypothetical monopolist test for market definition (which the Commission has adopted in its Market Definition Notice[48]) to test whether GE and Honeywell engines were in the same market or whether a market that included both company's engines could be defined in which prices would not be constrained by aircraft powered by engines made by Pratt & Whitney or Rolls Royce. It is unimaginable that a U.S. court would find that the U.S. antitrust agencies had sustained their burden of proof as to market definition based on the type of anecdotal evidence on which the Commission and the CFI relied here.

This portion of the CFI's opinion also raises serious due process concerns. The Commission apparently did not cite either of these two sets of evidence in its Statement of Objections and did not include them in the case file to which it gave GE access. This raises a serious concern as to whether GE was given fair notice of the evidence on which the Commission intended to rely so that it could respond to it. In addition, the CFI allowed the Commission to adopt a completely different methodology for market definition in this case than it had adopted in its last decision involving the same industry. In that case, in approving an engine alliance between GE and Pratt & Whitney for the development of engines for the Airbus 380 and Boeing 747-400, the Commission had defined the market in terms of only first-level competition between manufacturers to obtain certification on a platform, without regard to second-level competition among platforms.[49] The CFI held that the parties had no legitimate expectation that the Commission would follow its own prior decisions and that the Commission was not even required to set out its reasons for reaching a different conclusion in this case than in its earlier decision in the same industry.[50] While there may have been legitimate justifications for reaching a different conclusion based on differences in the record, one would expect the decision maker to be required to explain its reasons for reaching a different conclusion.

2. Engines for corporate jet aircraft. The CFI's decision affirming the Commission's decision as to the market for engines for corporate jet aircraft is even less persuasive than its decision as to regional jet aircraft. Again, the court acknowledged that GE's and Honeywell's engines are so different in terms of thrust and design as not to be direct substitutes, and that the merger could harm competition only by reducing second-level competition among aircraft powered by GE and Honeywell engines. The court cited no evidence that there is any such competition among engine manufacturers with respect to corporate jet aircraft, merely relying, "*mutatis mutandis*," on its analysis of the market for large regional jets.[51]

Even if the notion of second-level competition could be extended from the market for regional jets to the market for corporate jets, GE and Honeywell have much smaller shares in that market than they do in the putative market for large regional jets—50–60 percent as compared to 100 percent. Given these much smaller shares, it would seem hard to tell a plausible unilateral or coordinated effects story under which the merged entity would be able to raise prices profitably post-merger because of a reduction in second-level competition. This makes it all the stranger that the CFI assumed that its analysis of the market for engines for large regional jets could be so easily extended to corporate jets—especially since a key part of the court's analysis of the regional jet market turned on the fact that the merger would have given the merged entity a complete monopoly over that market, something that it plainly would not do in the market for engines for corporate jets.[52]

3. Small marine gas turbines. The final market in which the Commission found a horizontal overlap between GE and Honeywell is the market for small marine gas turbines, which the Commission defined as having a power range of 0.5 to 10 MW. The CFI's discussion of this market is so abbreviated that the court does not even identify what the market shares of the two firms were in this alleged market. It appears that GE produced only one engine in this size range, and that the Commission attributed to it a market share of 25–30 percent. GE pointed out that this market share could not be reconciled with the Commission's statement, in the same recital, that GE had only a 10–20 percent share of a narrower market for turbines in the 0.5 to 5 MW range, because the only marine turbine GE manufactured fell into this lower range.[53] The CFI refused even to consider this argument because it was not included in GE's appeal and was raised for the first time at the hearing, but it leaves one uneasy to have so important an issue decided on a procedural technicality.

More broadly, there is a serious question as to whether there is a separate market for marine turbines in this size range. In so defining the market, the Commission apparently relied entirely on the opinions of two of the three other competitors who produced marine turbines in this size range, UTC and Rolls Royce, both of which were opposing the merger generally. One of these, UTC, acknowledged that the 0.5 to 10 MW range was arbitrary and that some industry publications defined the market as extending to 13 MW turbines. The third competitor, Solar Turbines, submitted that the market was much broader and should have included industrial turbines, which it said could be used interchangeably with marine turbines for many applications.

Without access to the record, it is impossible to say with confidence whether the Commission's market definition and market share estimates were right or wrong. But there are enough serious questions left by the CFI's decision with respect to this market to create concern about the analysis.

Conclusion

Decisions that split the baby are rarely satisfying. This one is more disquieting than most because in affirming the Commission's prohibition of the GE/Honeywell merger on the basis of the horizontal overlaps between the two parties, the CFI reverted to a purely structural analysis that is wholly discordant with its economically sophisticated analysis of the conglomerate effects portion of the Commission's decision and of the Commission's coordinated effects theory of competitive harm in the *Airtours* case. Even more troubling, the court accepted novel definitions of the relevant markets that are supported only by fragments of anecdotal evidence and opinion testimony from opponents to the merger, without requiring that the Commission substantiate those definitions with hard empirical data, as the U.S. courts generally require.

The one comforting thought is that the Commission's decision itself was the product of a merger clearance process that has since been thoroughly reformed. It is hard to imagine the Commission today, with a highly-qualified chief economist and peer review panels, defining markets on the basis of evidence as weak and fragmentary as the evidence on which it relied in this case. For that reason, the horizontal portions of the CFI's decision may, in time, come to be seen as nothing more than a historic artifact, with no lasting significance. ■

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1 Charles A. James, International Antitrust in the 21st Century: Cooperation and Convergence, Remarks Before the OECD Global Forum on Competition, Paris (Oct. 17, 2001), *available at* http://www.usdoj.gov/atr/public/speeches/9330.htm.

2 *Id.*

3 *See* William J. Kolasky, Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels, Remarks Before the George Mason University Symposium (Nov. 9, 2001), *available at* http://www.usdoj.gov/atr/public/speeches/9536.htm; William J. Kolasky, *GE/Honeywell: Continuing the Transatlantic Dialogue*, 23 U. PA. J. INT'L ECON. L. 513 (2002); Götz Drauz, *Unbundling GE/Honeywell: the Assessment of Conglomerate Mergers Under EC Competition Law*, 25 FORDHAM INT'L L.J. 885 (2002); Dimitri Giotakos, *GE/Honeywell: a Theoretical Bundle Assessing Conglomerate Mergers Across the Atlantic*, 23 U. PA. J. INT'L ECON. L. 469 (2002).

4 Commission Decision 2004/134/EC, General Electric/Honeywell, 2004 O.J. (L 48) 1; Commission Decision 2004/124/EC, Tetra Laval/Sidel, 2004 O.J. (L 43) 13.

5 Case T-342/99, Airtours v. Commission, 2002 E.C.R. II-2585; Case T-310/01, Schneider Electric v. Commission, 2002 E.C.R. II-4071; and Case T-5/02, Tetra Laval v. Commission, 2002 E.C.R. II-4519.

6 Commission Decision 2005/621/EC, Oracle/PeopleSoft, 2005 O.J. (L 218) 6; Commission Decision 2005/188/EC, Sony/BMG, 2005 O.J. (L 62) 30.

7 Council Regulation (EC) No 139/2004 of 20 January 2004 on the Control of Concentrations Between Undertakings (EC Merger Regulation), 2004 O.J. (L 24) 1.

8 *Supra* note 5 and Case C-12/03 P, Commission v. Tetra Laval BV, *available at* http://curia.eu.int/jurisp/cgi-bin/form.pl?lang=en (not yet reported).

9 *Supra* note 5.

10 *Id.* ¶ 155.

11 *Id.* ¶ 148.

12 *Id.* ¶ 159.

13 *Supra* note 8.

14 Case T-210/01, General Electric v. Commission ¶ 215, *available at* http://curia.eu.int/jurisp/cgi-bin/form.pl?lang=en (not yet reported).

15 Judgment ¶ 114. *See, e.g.*, Case 322/81, Michelin v. Commission, 1983 E.C.R. 3461 ¶ 30.

16 United States v. Grinnell Corp., 384 U.S. 563, 570–71 (1966).

17 United States v. Aluminum Co. of Am., 148 F.2d 416, 424 (2d Cir. 1945).

18 Judgment ¶ 163.

19 Id. ¶ 173. And going outside the record, the *Financial Times* reported that in 2004, Rolls Royce won more engine orders overall than GE—40 percent as compared to 34 percent. *See* Kevin Done & Mark Odell, *Rolls-Royce Powers Ahead of GE Aircraft*, FIN. TIMES, Feb. 11, 2005, at 22.

20 Judgment ¶ 238.

21 *Id.* ¶ 242.

22 *Id.* ¶ 288.

23 *Id.* ¶ 295.

24 *Id.* ¶ 307.

25 *See, e.g.*, *id.* ¶ 330.

26 *Supra* note 3.

27 Cargill, Inc. v. Montfort of Colo., Inc., 479 U.S. 104, 116 (1986).

28 Lawrence H. Summers, *Competition Policy in the New Economy*, 69 ANTITRUST L.J. 353, 358 (2001).

29 Kolasky, *GE/Honeywell: Continuing the Transatlantic Dialogue*, *supra* note 3.

30 Verizon Communications Inc. v. Law Offices of Curtis V. Trinko LLP, 540 U.S. 398, 414 (2004).

31 Judgment ¶ 65 (emphasis added).

32 *Id.* ¶ 69 (emphasis added).

33 *See also id.* ¶ 465 (holding that "the Commission did not establish, by reference to the objective commercial and economic circumstances of the case, that it would necessarily have been in the interests of the merged entity to engage in mixed bundling following the merger.").

34 *Id.* ¶ 71.

35 *Id.* ¶ 72.

36 *Id.* ¶ 338.

37 *Id.* ¶ 339.

38 *Id.* ¶ 363.

39 *Id.* ¶ 364.

40 *Id.* ¶ 425.

41 *Id.* ¶ 429.

42 *Id.* ¶ 439.

43 *Id.* ¶ 453.

44 *Id.* ¶ 466.

45 *Id.* ¶ 478.

46 *Id.* ¶ 479.

47 United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004); United States v. Sungard Datasystems Inc., 172 F. Supp. 2d 172 (D.D.C. 2001); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.D.C. 2004).

48 Commission Notice on the Definition of Relevant market for the Purposes of Community Competition Law, 1997 O.J. (C 372) 3.

49 Commission Decision 2000/182/EC, GEAE/P&W, 2000 O.J. (L 58) 16.

50 Judgment ¶¶ 512–514.

51 *Id.* ¶ 569.

52 *Id.* ¶ 539.

53 *Id.* ¶ 593.