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ANTITRUST AND COMPETITION LAW UPDATE

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The CFI Upholds the Commission's Decision in *GE/Honeywell* but Criticizes the Commission's Analysis of Conglomerate Effects

On 14 December 2005, the European Court of First Instance (CFI) upheld the European Commission's (Commission) 2001 decision prohibiting the merger between GE and Honeywell,[1] *despite finding errors in the Commission's assessment of the conglomerate and vertical effects of the merger. The CFI found that these errors did not affect the overall conclusion of the Commission: that the proposed merger created or strengthened a dominant position in certain markets.*

Following the judgments of the CFI and of the European Court of Justice in the Tetra Laval *case,*[2] *the* GE/Honeywell *judgment acknowledges that conglomerate mergers may lead to anticompetitive effects in certain circumstances, but confirms the very high standard of proof that the Commission has to meet in order to prohibit such mergers. This does not mean that conglomerate theories are dead under EC merger control. The CFI did not dismiss the legal and economic theories on conglomerate effects put forward by the Commission, but instead confirmed that the application of such theories must be supported by accurate, reliable and convincing evidence.*

As for future enforcement policy in this area, if the Commission were to challenge conglomerate mergers in the future, it would need to ensure that its case was not only well-grounded in its theory of anticompetitive harm, but also that the evidentiary record in support of the theory will withstand judicial scrutiny. As a consequence, while the Commission will rarely seek to prohibit conglomerate mergers, the Commission will demand the notifying parties and other entities involved in the market investigation to provide information and data of the standard and quality required by the European courts.

The Commission's Decision

On 5 February 2001, GE and Honeywell notified the Commission of their intention to merge in order to obtain regulatory clearance in Europe. On 3 July 2001, after an in-depth investigation, the Commission decided to prohibit the merger, which would have resulted in the largest industrial combination in the world.

1. See Case M.2220, *General Electric/Honeywell*, of 3 July 2001.

2. See Case T-5/02, *Tetra Laval v Commission*, [2002] ECR II-4381 and Case C-12/03 P, *Commission v Tetra Laval*, [2005] ECR I-987.

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The Commission found that GE alone already held a dominant position in the markets for jet engines for large commercial and large regional aircrafts. It principally relied on GE's existing strong position in these markets, combined with its financial strength and vertical integration into aircraft leasing. The Commission's investigation also concluded that Honeywell was the leading supplier of avionics and non-avionics products, as well as engines for corporate jets and engine starters. Therefore, according to the Commission, the combination of the two companies' activities would have resulted in the creation or strengthening of dominant positions on a number of markets.

The Commission relied on two separate theories of competitive harm:

(1) The merger would have strengthened GE's existing dominant positions in the markets for jet engines for large commercial and large regional jets.

(2) The combination of GE and Honeywell would have resulted in the creation of a dominant supplier in the markets for avionics, non-avionics and corporate jet engines and on the market for small marine gas turbines.

Dominance would have been created or strengthened as a result of horizontal overlaps in some markets, as well as through the extension of GE's financial power and vertical integration to Honeywell activities and the combination of their respective complementary products. The Commission concluded that such integration would have enabled the merged entity to leverage the respective market power of the two companies into the products of the other, with the effect of foreclosing competitors and thereby eliminating competition in these markets.

One of the main concerns raised by the Commission related to the fact that the merger would have facilitated *bundling practices*, and in particular using discounts on packages of equipment, often called "mixed bundling", i.e., selling a bundle or a package of components (in this case GE's jet engines and Honeywell's avionics and non-avionics products) at a price lower than the total price of the components, purchased separately. The finding that the merged entity would engage in mixed bundling rested on the theory of portfolio or range effects.

A second concern raised in the decision related to the ability of the merged entity to benefit from GE Capital's *financial strength*, which would have allowed GE to rely on almost unlimited financial resources. GE could therefore take risks in product development that its rivals could not afford, and could offer customers discounts and other terms that its rivals would not be in a position to offer, thus, according to the Commission, ultimately marginalizing or driving the competitors from the market.

The Commission was also concerned about GE's ability to engage in *vertical foreclosure* through GECAS (its aircraft leasing operation), if GECAS were to extend its GE-only procurement policy to Honeywell's systems. This practice would have forced airframe manufacturers to purchase GE's bundled package of products and standardize their fleets on GE-powered aircrafts, again marginalizing GE's and Honeywell's rivals or driving them from the market.

In order to address these concerns, GE proposed a number of undertakings during the administrative procedure that the Commission considered insufficient to remove the identified competition problems. According to the Commission, given the nature of the competition concerns and the fact that the GE was unable to propose undertakings that would have removed them, the Commission was left no choice but to prohibit the proposed merger.

On 12 September 2001, GE and Honeywell lodged separate appeals to the CFI seeking the annulment of the

Commission's decision prohibiting the proposed merger. GE's and Honeywell's competitors Rolls Royce and Rockwell Collins intervened in both cases in support of the Commission.

The CFI's Main Findings

On 14 December 2005, the CFI decided that although the Commission made errors of assessment in its decision—in particular in its analysis of conglomerate effects—the finding that the merger between GE and Honeywell would have created or strengthened dominant positions on several specific product markets was sufficiently grounded. The CFI thus upheld the Commission's decision, while rejecting the Commission's reasoning in the principal markets of large commercial jet engines and avionics that had been the principal competition concern and focus of debate.

According to the CFI, the Commission did not make a manifest error of assessment when it concluded that GE held a pre-merger dominant position on the market for jet engines for large commercial aircrafts. The Commission had rightly concluded that GE's market share could be indicative of pre-merger dominance, particularly in connection with other factors such as the vertical integration of the GE Group, the general state of competition in the market concerned, and the lack or weakness of competitive constraints.

However, the CFI found that the Commission's decision on the proposed merger was vitiated by manifest errors in three different respects:

(1) *Vertical effects resulting from GE and Honeywell vertical relationship.* According to the CFI, the Commission did not sufficiently establish that the vertical relationship between GE's engines and Honeywell's engine starters (a key input in the manufacturing of engines) would strengthen GE's existing dominant position. More specifically, since the Commission's theory concerning the anti-competitive effects resulting from that vertical relationship hinged on the merged entity's future behavior, the CFI found that the Commission had failed to produce convincing evidence as to the likelihood of that behavior. The CFI expressly referred to the *Tetra Laval* judgments,[3] which held that the Commission must bring convincing evidence, in particular when it takes future conduct into account, and that its analysis must be particularly plausible with regard to effects that will emerge after a certain lapse of time. The Commission had also failed to take into due consideration the deterrent effect of Article 82 EC on the future behavior of the merged entity.

(2) *Conglomerate effects resulting from GE's financial strength and vertical integration.* Again in light of the *Tetra Laval* judgments, the CFI found that the Commission had failed to establish to a sufficient degree of probability that, as an effect of the merger, GE would have had the ability to transfer the commercial power represented by GE Capital's financial strength and GECAS' vertical integration to Honeywell's markets for avionics and non-avionics products—and had failed to prove, on the basis of convincing evidence, that it was likely that GE would engage in such conduct post-merger. The CFI also found that the Commission had failed to adequately establish that those practices, assuming that they would be put into effect, would have been likely to create dominant positions on the various avionics and non-avionics markets concerned.

3. See above.

(3) *Conglomerate effects resulting from bundling practices.* An important pillar of the Commission's 2001 decision rested on the finding that, after the merger, GE would have had the ability (unlike its competitors) to offer packages encompassing both engines and avionics and non-avionics products. The Commission had also concluded that because such a strategy was clearly in the commercial interests of the merged entity, GE would probably engage in bundling after the merger. Applying the *Tetra Laval* strict standard of review for conglomerate effects, the CFI proceeded to determine whether the Commission had established, on the basis of convincing evidence, that the merged entity would not only have had the ability to engage in bundling practices (pure bundling, technical bundling and mixed bundling), but also that it would have been likely to engage in those practices to the detriment of consumers. After a detailed review of the economic evidence brought forward by the Commission to support its findings, the Court concluded that the Commission had not established that the merged entity would have bundled sales of GE's engines with Honeywell's avionics and non-avionics products. In the absence of such bundled sales, the mere fact that the merged entity would have a wider range of products than its competitors was not sufficient to establish that dominant positions would have been created or strengthened.

Despite having found that the Commission made these manifest errors of assessment, the CFI concluded that the Commission's findings relating to the horizontal effects of the merger on three other markets were sufficient to establish that the decision prohibiting the merger between GE and Honeywell was well founded.

In particular, the CFI upheld the Commission's conclusion that the merger would have created a monopoly on the worldwide market for jet engines for large regional aircraft. Similarly, the CFI rejected GE's appeal with regard to the Commission's findings concerning the creation of dominant positions on the market for engines for corporate jet aircraft and on the market for small marine gas turbines. The Court also upheld the Commission's rejection of the undertakings proposed by the parties to resolve the competition problems that the merger would create on these markets.

The CFI also rejected the parties' remaining procedural claims alleging that the Commission had infringed their rights of defense (i.e., alleged limited and late access to file) in the course of the administrative procedure

Finally, the CFI dismissed Honeywell's application, largely on technical grounds relating to the scope of the action brought.

Principal Implications of the CFI Judgment

The *GE/Honeywell* judgment is not a groundbreaking judgment, but it confirms the trend of cases—started a few years ago with the *Airtours, Schneider* and *Tetra Laval* judgments—imposing a rigorous standard of proof on the Commission when it comes to the factual and economic evidence required to substantiate a prohibition decision in EC merger control. In this respect, the judgment is likely to affect the future application of merger control rules by the Commission and by national competition authorities.

Conglomerate theories: high standard of proof confirmed. The judgment confirms that while conglomerate mergers may have anticompetitive effects under certain circumstances, the Commission must show that, in all likelihood, a dominant position will be created or strengthened in the relatively near future by clearly identified leveraging practices leading to effective competition in the market being significantly impeded. Unsupported

speculations about the merged firm's future conduct and its effects will not suffice.

High quality of the Commission's evidentiary record. Once again, along with the *Airtours, Schneider* and *Tetra Laval* judgments, the CFI calls for a high-quality evidentiary record in order to support a prohibition decision under the EC Merger Regulation. The Court recognizes that the quality of the evidence in the Commission's file, whether of an empirical, econometric or qualitative nature, is a key factor in the review of the theories put forward to block a merger. The parties, as well as the Commission, must therefore be attentive to building an evidentiary record that is as complete and convincing as possible—not just for the administrative procedure, but also to prepare the ground for a successful judicial review. The *GE/Honeywell* judgment confirms that, while the Commission has a margin of discretion as to the economic theories applied and to appraisals of an economic nature, the Courts will verify that the economic evidence relied on is factually accurate, reliable and consistent. As in past cases, the CFI's analysis in *GE/Honeywell* was strictly focused on the record built during the administrative procedure.

Effects on Commission's future policy on conglomerate mergers. An interesting policy question is to what extent this judgment (along with the *Tetra Laval* judgments) will affect the Commission's enforcement policy concerning conglomerate mergers. While these cases will likely discourage the Commission from blocking mergers on the basis of conglomerate theories, the CFI made clear that these theories are a plausible basis to prohibit a merger in certain circumstances. The *GE/Honeywell* judgment will likely push the Commission to ensure that any conglomerate cases it does bring are supported by robust evidence.[4]

US/EC convergence on the standard of review for conglomerate mergers. A welcome consequence of the *GE/Honeywell* judgment together with *Tetra Laval* is that it moves closer the legal and economic standards of review of mergers that potentially raise conglomerate issues when scrutinized by European and US antitrust agencies. This outcome will contribute to the elimination of the "chilling effect" on transatlantic mergers, a direct consequence of the legal uncertainty resulting from the Commission's decision in *GE/Honeywell*.

A substantive issue: financial strength as a factor in establishing dominance. The Commission's finding that GE had a dominant position in the market for jet engines for large commercial aircraft prior to the merger rested in part on the financial and commercial strength of two of its subsidiaries (GE Capital and GECAS). The appeal raised the question of whether EC merger control rules impose penalties on companies merely on account of their size or their financial resources rather than viewing financial strength as a positive efficiency that can be replicated. The CFI held that the Commission could legitimately rely on the fact that GE had internal commercial and financial means—which it had exploited in some cases to win contracts. However, the Court also added that the Commission must establish, on the basis of convincing evidence (such as internal documents), that the merged entity is likely to make future use of that financial power in markets where prior to the merger there was no scope for it, in order to establish that the merger will create or strengthen a dominant position on these markets. Such evidence cannot, as a general rule, consist exclusively of evidence of past conduct.

4. The Commission's willingness to pursue conglomerate cases after *Tetra Laval* is evidenced by its decision in *Procter & Gamble/Gillette* (see Case M.3732, *Procter & Gamble/Gillette*, of 15 July 2005).

This part of the Commission's theory—which has been upheld by the CFI—had been criticized by commentators, particularly in the United States, in so far as it relies on the long-abandoned assumption that "big is bad." Such an assumption—failing to consider whether there are relevant efficiency-enhancing considerations—may ultimately seek to protect competitors at the expenses of consumers.

"Precedential" nature of Commission's past practice. In an interesting passage of the judgment, the CFI recalls that the parties are not entitled to call the Commission's findings into question on the ground that they differ from those made previously in a different case, even where the markets at issue in the two cases are similar, or even identical. Companies do not have grounds for a legitimate expectation that a previous Commission's practice will be maintained when the European Community institutions exercise their discretion. The CFI noted that although it is a general principle of EC law that the Commission is required to give an explicit account of its reasoning for a decision, it does not follow from that principle that the Commission must, in addition to stating the reasons for its decision based on the current case-file, set out its reasons for diverging from the previous case.

Thomas Mueller and Antonio Capobianco are the authors of this update.

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