

# GE-Honeywell

## From the Apple of Discord to a Meeting of Minds?

by Riccardo Gotti Tedeschi

### KEY FINDINGS

- The vicissitudes of the failed merger underscore the limits of the current criterion of dominant position.
- A regulatory framework is urgently needed that is flexible and less invasive
- The differences between the antitrust approaches on the two sides of the Atlantic are mainly of a "cultural" nature
- The European approach is rooted in a bureaucratic mindset
- The vicissitudes of the recent years helped to bring forward a needed reform of the dominant position criterion
- Globalization is pushing from confrontation to a much-needed convergence of both approaches.

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*The European Commission decision on the merger between GE and Honeywell can certainly be seen as an indication of a cleavage between the American and the European competition models. However, in a more optimistic vein, it may yet turn out to be the turning point in the direction of a hoped for scenario of a progressive convergence of both antitrust models.*

Pending the forthcoming decision by the Court of First Instance on the appeal against the July 2001 decision of the Commission to oppose the merger between GE and Honeywell, the contrast between the American and the European antitrust policy is worth considering, as well as the practicable way forward.

In the course of a few weeks, in September-October 2002, the Commission was flatly defeated in the Court of First Instance on three mergers it had previously blocked.<sup>1</sup> These events have undoubtedly facilitated the reform of the Merger Regulation, enacted on May 1st, 2004.

Importantly, in rejecting the Commission's decisions the Court emphasized the weakness of the economic analysis underlying the conclusion that the rejected mergers were liable to harm competition. These three decisions did undermine the whole Commission's case and underlined the limits of a notion of "dominant position" that is under many respects hostile to the com-

panies' global growth that the markets fusion process dictates.

The companies that characterize the European industrial makeup are large if compared to their home country, and relatively small in relation to the larger market they are supposed to serve. In such conditions, mergers—as a way to create synergies between companies—ought to be encouraged. To this end a flexible regulatory framework is needed that is not informed by the mindset of invasive management of the markets.

Apparently this demand was accommodated, since in the two-and-a-half years hence only a merger was blocked by the new European Commissioner, the Dutch Neelie Kroes. In the event, the prospective operation entailed the acquisition of GDP by EDP and ENI, and the Commission's action was based on the assumption that the scheme was bound to reinforce the dominant position of EDP in the Portuguese market for gas and electricity distribution.<sup>2</sup>

Still, there are fears that the apparent Commission's inaction in the last

few years does not signal a turning point, but rather an attempt to mollify the courts after three remarkable setbacks.

Realistically, and despite the adoption of a new Merger Regulation, the conclusion is that the differences between the American and the European antitrust frameworks are mainly “cultural” ones. The latter is characterized by a number of inherent pitfalls, clear indicators of a bureaucratic heritage that will be hard to overcome.

### *GE-Honeywell*

It is hard to tell what Jack Welch, Chairman and CEO of General Electric, was thinking when he signed off the proposed acquisition of Honeywell. Perhaps delaying his retirement of a few months was worth crowning his career with this gem: a 42 billion dollars deal, supported by the whole U.S. Administration. But Welch was not reckoning with the European antitrust.

On February 5th, 2001, GE and Honeywell had notified their merger deal to obtain a green light from the European Commission. The following month, in the so-called “Phase 1,” a number of companies on both sides of the Atlantic presented their objections and played an active role in the subsequent hearings: among them, both the American United Technologies and the British Rolls Royce raised several objections to the proposed merger.

On the following March 1st, the Commission started a full blown investigation (“Phase 2”), which pointed out that GE already featured a dominant position in



the market for large commercial and regional airliners jet engines.

It has been reported<sup>3</sup> that on July 3rd the Commission, after a discussion of just a few minutes and without hearing any countervailing arguments,<sup>4</sup> unanimously approved the proposal of Commissioner Monti to block the largest industrial merger ever attempted and already approved by the antitrust office of the U.S. Department of Justice.

As evidence of such dominant position, the Commission pointed out several facts: foremost among them the strong market position of GE, and the presence of GE Capital, its financial arm, which alone generated some half of the group’s consolidated revenue with a turnout of over 370 billion dollars, or about 80% the value of the whole GE group. The Commission concluded that GE Capital allows GE as a whole to take greater risks in the development of its products and absorb any failure in an industry characterized by huge long-term investments.

The vertical integration with the airliner leasing business was also an element leading the Commission to conclude that GE’s position was in fact dominant in that market. The investigation also showed that Honeywell is the leading vendor of avionics and non-avionics products, as well as being market-leader in business aircraft engines and auxiliary power units (an essential component of modern aircraft).

In the opinion of the Commission, the merger, which the two companies deemed a perfect synergy, would have left GE-Honeywell with a dominant position in the markets for the supply of avionics, non-avionics and corporate jet engines, as well as strengthening



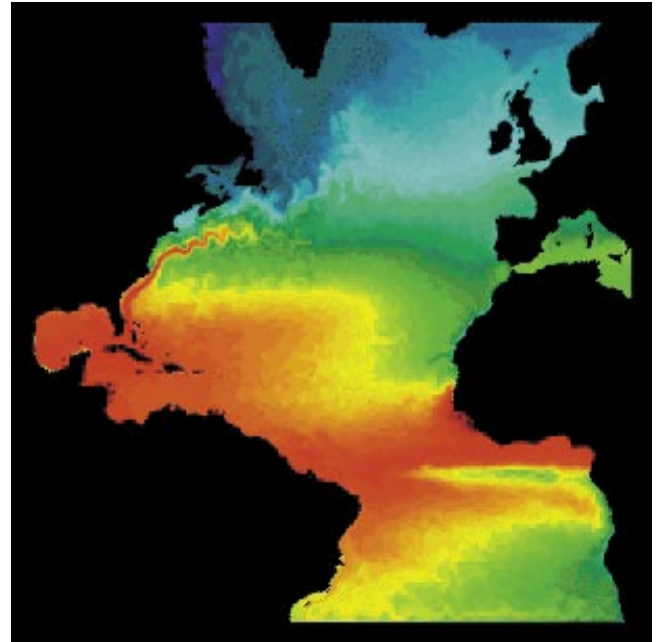
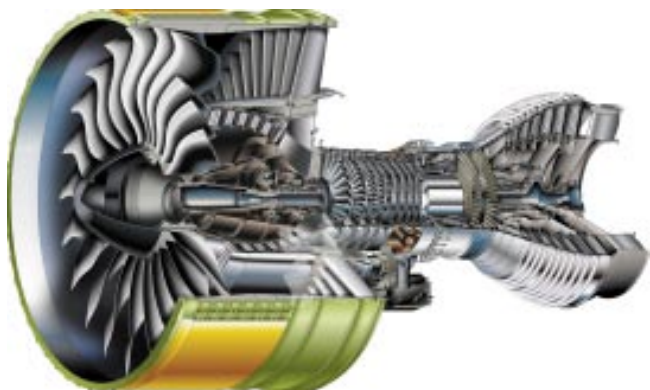
GE's existing dominant position in jet engines for airliners and regional jet aircraft.

Such dominant positions were bound to be further strengthened by the overlap of both companies' businesses in some markets and by extending to Honeywell the benefits of the financial might and the vertical integration of GE, as well as by the combination of their complementary products. It was thus feared a case of bundling/tying, namely the combined sale of complementary products at a total price lower than the sum of the prices of the separate products. In practice, after the merger the new concern could have offered its customers the change to purchase GE's products at lower prices when combined with Honeywell's, thus raising barriers to competitors in both markets.

During Phase 2, GE's advisors—after complaining of having had less than two weeks to counter the Commission's objections, "despite the Commission and [GE's and Honeywell's] competitors having co-operated for six months"<sup>5</sup>—managed to dismiss the allegation of bundling. However, the vertical integration was still deemed to be a grave threat to competition.

Despite a number of divestment agreements reached with the Commission as a condition for allowing the merger to proceed (as the sale of the helicopter engine division), Commissioner Monti wanted much more. He went as far as to demand the sale to a competitor of 19.9% of GECAS (the arm of GE operating its airliner leasing business), so as to guarantee a non-discriminatory approach in the commercial strategy of GECAS.

"It would have been like asking Jacques Nasser [President and CEO of Ford] to drive a Toyota for 20% of the day," was the down-to-earth comment of the economist Barry Nabeluff, one of the advisors of GE.



On June 28th GE proposed a number of further remedies, but to no avail: in the opinion of the Commission the new package did not sufficiently address the observed problems, especially considering of the advanced stage of the proceedings.

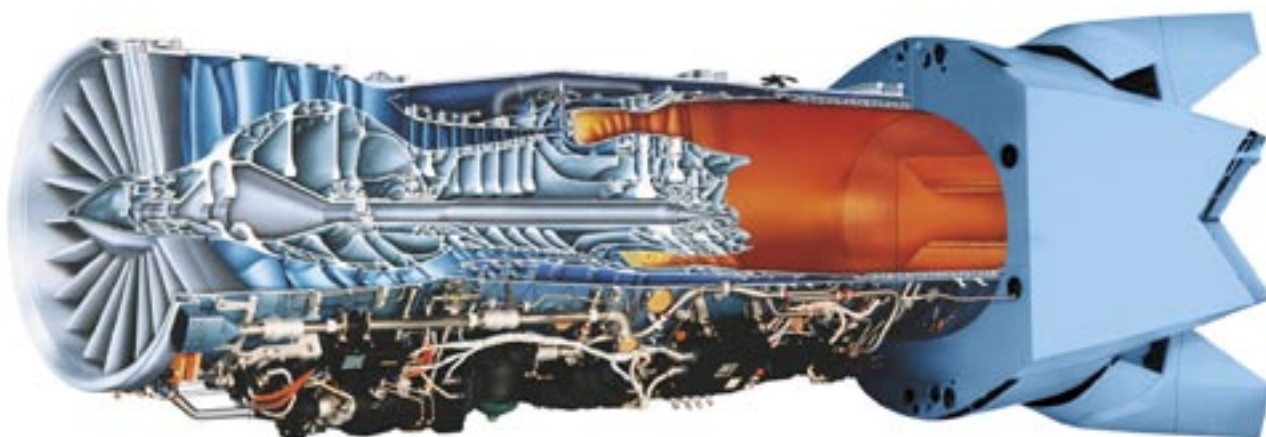
On July 3rd, as already remarked, the decision to block the merger was taken. Since, as Commissioner Monti stated, "we might interpret facts differently," the resulting decision contrasted starkly with the American authority's.

A disappointed GE accused the European Commission's approach to diverge significantly from the one followed by the American, as well the Canadian, authorities and those of a dozen of jurisdictions in the world that had already approved the deal. GE claimed that the merger would have benefited customers in terms of quality, service and prices.

Such was the demise of this most ambitious industrial project.

### *Analysis*

Four years later it can be observed that the sacrifice of the failed merger and the vast debate it elicited, as well as the Green Paper published by the Commission itself in late 2001 and the three decisions of the Court of First Instance in which the actions of the Commis-



sion were reversed contributed to a much needed reform of the criterion of dominant position.

In fact, Article 2 of the new Regulation<sup>6</sup> introduces a significant innovation regarding the appraisal of mergers: the creation or the strengthening of a dominant position is no longer the *one and only* criterion the Commission must consider in establishing whether a merger is compatible with the single European market. Since the new Regulation came into force a year ago, the Commission is expected to assess whether the proposed merger “would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.” The new dominance criterion is meant to be closer to the approach used by the American authorities, namely the so-called Substantial Lessening of Competition Test (SLC Test), but it seems to widen the scope of the old criterion.

In actual fact, the Commission opted not to wholeheartedly embrace the American standard: during the development of the Regulation, a wide debate occurred on the dominant position criterion in which the supporters of change emphasized the need to keep the notion of dominance for the purpose of Article 82 of the EU Treaty (on the abuse of a dominant position) apart from the notion of dominance for the purpose of merger control. At the same time, the opponents of a reform feared the consequences of discarding a longstanding EU case law pertaining to the notion of

dominance in favor of embracing the foreign and unfamiliar case law related to the SLC Test. At the same time, they deemed such a change superfluous in view of the substantial concurrence of the decisions made under both criterions (with the obvious exception, of course, of GE-Honeywell...).

Although the conservatives prevailed in the debate, a number of authoritative opinions in favor of the SLC Test were heard, some of which from the governments of some Member States.

A closer look is thus warranted into a facet of the merger appraisal process that plays a fundamental role in any comparison of the two approaches: namely, the efficiencies created by a merger even when it brings about a dominant position.

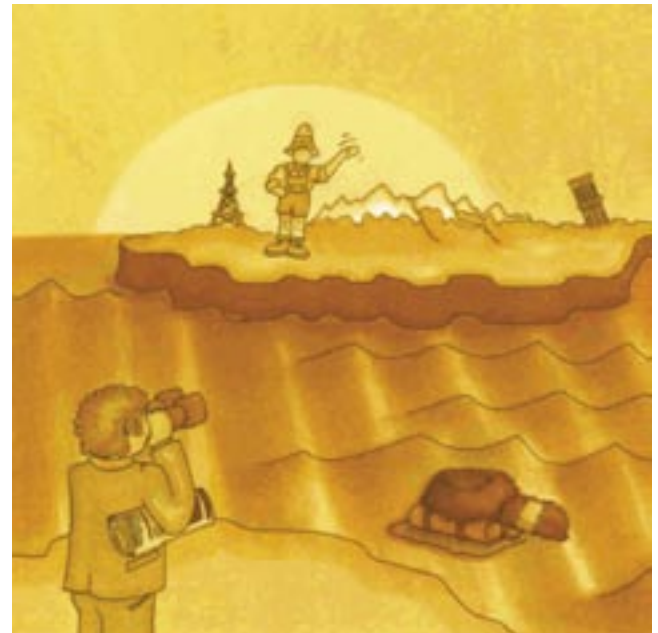
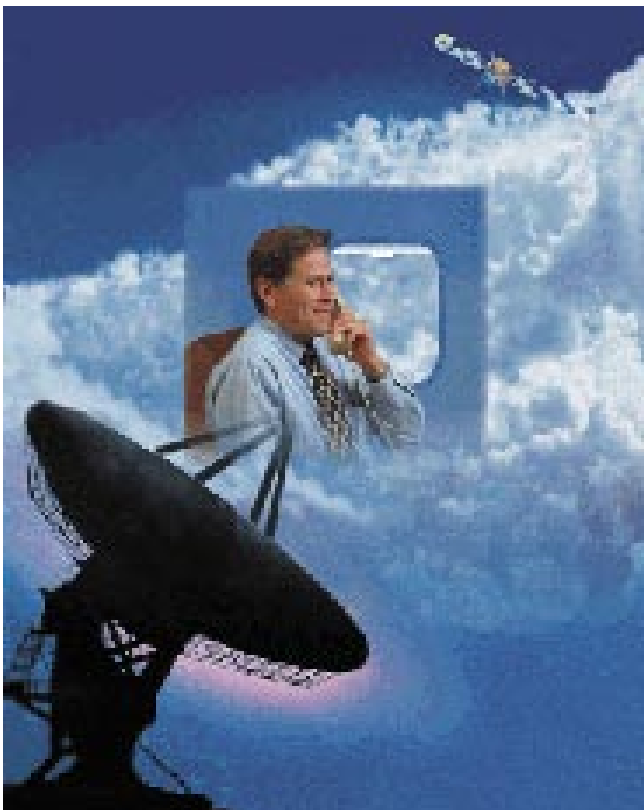
The debate on the role and the significance of efficiencies was started by the Commission with its Green Paper in 2001, with the aim to arrive to an understanding of *how* and *to what extent* the efficiency benefits of a merger ought to be taken into account.

It is worth to emphasize that the same efficiencies play a significant role in Article 81 of the Treaty (regarding the prohibition of agreements between companies), which states that efficiencies are to be taken into account in view of an exemption from the general ban against agreements between undertakings.<sup>7</sup>

Since the new Merger Regulation 139/04 came into force, the role played by efficiencies when assessing the impact of a merger has undoubtedly become a strong extenuating circumstance, going as far as to be deemed to offset the adverse impact on competition that a merger can engender.

A turning point can already be spotted in the twenty-ninth “Whereas” of the Regulation, in which it is stated that, when assessing the impact of a merger, “it is appropriate to take account of any substantiated and likely efficiencies put forward by the undertakings concerned. It is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that it might otherwise have and that, as a consequence, the concentration would not significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.”

This evolution is interesting: are efficiencies actually “redeemed”? Are they turning from evidence of a dominant position incompatible with the common market<sup>8</sup> to competition-enhancing agents? It would



appear that they are, although in a qualified way. In fact, efficiencies are deemed to produce competition-enhancing effects on the condition that they are *long-lasting* and and that they preserve a sufficiently competitive environment.<sup>9</sup>

In the American setting the structural elements of a merger can certainly feature prominently in its appraisal, but their significance can be overshadowed by other features, as the lowering of barriers to entry and the emergence of real benefits for the consumers.

Thus, if we contemplate the extreme case of a merger that brings about a *de facto* monopoly which nonetheless does not impose artificial limits to the market, the overall appraisal will be positive in an American setting, by virtue of the positive efficiencies engendered by the merger, while the assessment will be totally different in Europe, where the restructuring of the market is deemed to be the significant factor to take into account.<sup>10</sup>

It is essential, though, to be aware of the meaning attributed to the notion of competition and of the role that an antitrust authority ought to play. The GE-Honeywell affair points less to a technical than a political-economic difference between the U.S. and Europe.

In the opinion of a number of authoritative American critics (as evidenced in the writings of George Priest<sup>11</sup> and David Evans<sup>12</sup>), the European philosophy on competition and mergers features a significantly lesser degree of confidence than the American one in the ability of the market to self-correct any distortion caused by the exercise of economic power. As this fear became a tenet, Europe adopted an invasive regulatory framework with the aim of directing the way the market restructures, rather than allowing the competition between companies to reward the fittest among them.

The American competition philosophy is to be seen not only as a policy, but also (and mainly) as the expression of a culture that favors and rewards success and merit, an allegiance so deeply rooted in society that it becomes a veritable “moral commitment” of society itself.

In such a culture, the winners are above all the consumers. Competition in the market is instrumental to the offer of better products at lower prices. So long as a company grows, acquires market power, invests and continuously improves its products, what can it possibly owe to its less skilled competitors, which proved to be less innovative and unable to follow the same successful strategies?

Inevitably, one must conclude that, as market controls become more invasive and the economy is forced to follow a plan, enterprises are progressively more constrained in their freedom to create, innovate, grow and, ultimately, to invest and improve themselves and their own products.

It is worth noting the objections moved under this respect by Alan Greenspan, Chairman of the U.S. Federal Reserve, in an essay written in 1967. Greenspan sees in *capital markets*, as opposed to a rigid and protectionist regulation, the best watchdog of competition and prices: “So long as capital is free to move, it will unfailingly be attracted towards the areas offering the highest returns.”<sup>13</sup>

Conversely, in a protectionist market, wherein governmental agencies provide a safe haven for less competitive businesses (often, but not necessarily—as evidenced by the GE-Honeywell affair—small businesses), companies become less responsible and

less accountable for their results and do not feature the same urge to compete they would feel in an open market. The obvious outcome in such a setting is a steady depletion of the market’s innovation capabilities. It is reasonable to conclude that a merged GE-Honeywell, by virtue of emerging synergies and of the complementarity of the businesses of the original companies, was likely to bring benefits to the market and, therefore, to consumers and to bring innovation in the industry by raising technological standards.

## Conclusion

Globalization increasingly requires congruent rules and the European antitrust satisfied this need with the reform of the Merger Regulation and the introduction of the notion of “significant impediment to effective competition,” thus steering the confrontation with the American approach towards a hoped for agreement.

The 2001 Commission Green Paper, which cleared the way to the reform, was quite sanguine in granting both approaches—the American and the European—the achievement of comparable results; the same conclusion was reached by Barry Hawk, albeit with the acknowledgement that the fundamental difference between the two approaches is a substantial one: “The U.S. will listen to competitors, but tends to discount their views, while in the EU far more weight is given to competitors.”<sup>14</sup>

However significant the actual scope of the Regulation and its innovation potential may be, the “cultural” question still remains, which only time will satisfactorily answer. The long-awaited decision of the Court of First Instance on the appeal by GE-Honeywell is looming; if considered on the backdrop of the preceding decisions against the Commission, it would seem to give some hope to the American conglomerate, as well as providing the indication of a needed accord between Europe and the U.S.

## Endnotes

- 1: It is noteworthy that the Court's decision have overturned three very dissimilar operations, concerning the tour operators industry in Britain (Airtours/First Choice), the electrical equipment industry in France (Schneider/Le-grand), and the packaging industry in the Europe-wide market (Tetra Laval/Sidel). In all cases, despite the concessions offered by the parties, the Commission blocked the merger on the ground that it was bound to create or strengthen a dominant position in the relevant markets.
- 2: See European Commission press release IP-04-1455, December 9th, 2004.
- 3: *Corriere della Sera*, July 4th, 2001, p.6.
- 4: In fact, immediately after the brief relation of the relevant Commissioner.
- 5: Michael Elliot, "The anatomy of the GE-Honeywell disaster," *TIME* online edition (<http://www.time.com/time/business/article/0,8599,166732,00.html>).
- 6: The new Council Regulation No 139/2004 came into in force on May 1st, 2004, rescinding and replacing the former Regulation CE 4064/89 as amended by Regulation 1310/97.
- 7: See Article 81, Section 3, EC Treaty.
- 8: It is the so-called "efficiency attack," namely the understanding of efficiencies as a symptom—or better, an indicator—of the strengthening of a dominant position. This argument, advanced by F. Jenny and R. Whish, is the opposite of the so-called "efficiency defense," which sees efficiencies as a supporting element for a merger.
- 9: See European Commission Notice 2004/C 31/03, published on February 2nd, 2005, "Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings," Sections 76-88.
- 10: As stated by Richard Whish, the main concern of merger control in Europe is not only to avoid any abuse of dominant position by the merged entity, but also to preserve a market structure capable to guarantee the benefits of competition. See R. Whish, *Competition Law*, 5th ed., (London: Butterworths, 2001).
- 11: G. Priest, "L'antitrust negli Stati Uniti e in Europa. L'analisi," in *Mercato Concorrenza Regole*, 1 (2001), p.151.
- 12: D. Evans, "The New Trustbusters: Washington and Brussels May Part Ways," *Foreign Affairs*, 81, n.1 (January-February 2002), p.14.
- 13: Alberto Mingardi (ed.), *Antitrust, mito e realtà dei monopoli*, (Soveria Mannelli: Rubbettino and Treviglio: Leonardo Facco, 2004) p.61.
- 14: J. Greene, "Antitrust Action Moves to Europe," *Legal Times*, 24, n.14 (April 2001). In the same article, Commissioner Monti is quoted as stating that "competitors are a rather powerful source of information for overall assessment of mergers and potentially for the identification of remedies."



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