ESSAY

MERGERS IN GLOBAL MARKETS: GE/HONEYWELL AND THE FUTURE OF MERGER CONTROL

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1. INTRODUCTION

In October 2001, General Electric Company ("GE"), the largest corporation in the world and the number one producer of jet engines, announced the largest industrial merger in history. GE Chief Executive Officer ("CEO") Jack Welch stated that GE would acquire Honeywell, the largest worldwide supplier of non-engine aerospace equipment. Welch ventured that there would be no antitrust problems; the proposed merger would be conglomerate, not horizontal. The merger would merely bring together complementary products that were component parts of large jet aircraft.[1]

On May 2, 2001, the Antitrust Division of the U.S. Department of Justice cleared the merger after requiring a small spin-off of overlapping helicopter businesses.[2] On July 3, 2001, the European Commission prohibited the merger, finding it incompatible with the common market.[3]

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1 *See Antitrust: Merger Muddle*, ECONOMIST, June 23, 2001, at 11 (discussing the size of the GE/Honeywell merger).

2 Press Release, United States Department of Justice, Justice Department Requires Divestitures in Merger Between General Electric and Honeywell (May 2, 2001), *at* http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm.

3 Case COMP/M.2220, General Electric/Honeywell v. Commission (2001) [hereinafter GE/Honeywell], *available at* http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf, *appeal pending*, Action Brought on 12

The GE/Honeywell saga symbolizes the problems that confront a world in which markets are global, but law is national or regional.

This Essay addresses the problems and challenges posed by the incompatibility of national law with global markets. First, examining the GE/Honeywell merger, the Essay investigates why the European Union ("EU") concluded that the merger was anticompetitive, while the United States deemed the merger procompetitive. Second, the Essay considers solutions to the problem of international mergers without a body of international competition law.

2. SETTING THE STAGE

Competition law regulates the competition process and helps make markets function effectively while protecting the integrity of the market. More than ninety countries and regions have competition laws, and, of those, approximately sixty-five have merger control regimes.[4]

Predictably, different jurisdictions have somewhat divergent approaches in applying their competition laws; such laws are elements of political economy. U.S. antitrust law once embraced the goals of diversity, freedom from coercion, and economic opportunity for market players who lacked power.[5] Beginning in 1981, there was a paradigm change: antitrust intervention became inappropriate unless the proposed conduct or transaction threatened to lower output and thus raise prices.[6] Based on the assumption that markets and business decisions are usually efficient, or at least

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September 2001 by the General Electric Company against the Commission, 2001 O.J. (C 331) 24.

[4] *See* Statement of Charles A. James, Assistant Attorney General, Antitrust Division, Before the Subcommittee on Antitrust, Competition, and Business and Consumer Rights, Committee on the Judiciary, 8 (2002) ("There are now nearly 100 national and regional antitrust regimes in the international arena, with roughly 65 of those requiring some form of premerger notification."), *at* http://www.usdoj.gov/atr/public/testimony/200233.htm; U.N. TDBOR, Directory of Competition Authorities at 3, U.N. Doc. TD/B/COM.2/CLP/27 (listing the contact information for competition authorities in countries around the world), *at* http://www.unctad.org/en/docs/c2clp27.en.pdf.

[5] *See* Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust—Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. REV. 936, 944 (1987) (discussing the history and original goals of early antitrust regulation).

[6] *Id.* at 945.

more efficient than antitrust intervention, this "consumer welfare" model is regarded as a proxy to achieve efficiency.[7]

EU competition law is an integral part of the founding treaty of the European Community. The Treaty of Rome was intended to achieve one common market and the cohesion of the Member States by, among other things, enabling the free flow of goods, services, capital, and people, as well as preventing distortions of competition that stack the playing field.[8] Abuses of dominance are distortions of competition. Adopted only in 1989, merger control prohibits mergers that create or entrench dominance. European competition law accounts for a merger's effects on all players, including market actors and consumers, and exempts distorting agreements that are productive and efficient if consumers benefit from the combination's gains.[9]

U.S. and EU models tend to produce common outcomes. Both proscribe cartels and mergers of competitors that produce cartel-like behavior, as well as conduct or merger structures that are directly exploitative of consumers. However, in the area of single-firm exclusionary practices and the creation of market structures that facilitate them, the two systems are largely incompatible. Exclusionary practices foreclose market actors by exercises of power. They distort the playing field. Consumers find it more difficult to obtain the products and services of the fenced-out firms. However, even in the face of exclusionary practices, prices do not necessarily rise. There are scenarios in which a dominant firm may adopt practices that exclude competitors, but output may increase and prices may fall. For example, a firm that imposes a tie-in may achieve economies of scope, or it may increase its own output merely by charging each buyer what that buyer is willing to pay. Moreover, a dominant producer of complementary products tends to charge a lower total price than the sum of the prices charged by two separate dominant producers of each of the complementary products. This effect captures the producer's incentive to avoid double marginalization.[10] Therefore, the law of a jurisdiction that

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7 *Id.* at 957.

8 Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, 1997 O.J. (C 340) 1.

9 ELEANOR FOX, THE COMPETITION LAW OF THE EUROPEAN UNION, CASES AND MATERIALS (forthcoming 2002).

10 *See* United States Department of Justice Antitrust Division Submission for OECD Roundtable on Portfolio Effects in Conglomerate Mergers (Oct. 12, 2001) at

considers the distorting effect of uses of leverage to be anticompetitive will be more prohibitory than the law of a jurisdiction that mandates abstention in the absence of a probable rise in prices. This was the fault line in GE/Honeywell.

3. THE GE/HONEYWELL MERGER

GE is the world's largest producer of large and small jet engines for commercial and military aircraft. GE and its joint venture, GE Capital Aviation Services ("GECAS"), account for more than fifty-two percent of all engines in large commercial jets still in production. GE accounts for sixty to seventy percent of engines in large regional aircraft in production, forty to fifty percent of engines in the installed bases of large regional aircraft and ten to twenty percent (in both categories) of engines for corporate jets. The engine market is highly concentrated; Pratt & Whitney and Rolls-Royce are the world's second- and third- largest producers, respectively.[11] GECAS is one of the world's largest aircraft leasing companies and one of the largest buyers of airplanes. GECAS purchases about ten percent of all aircraft; along with its sister corporation, GE Capital, GECAS finances the purchase of airplanes and is an important airplane launch customer. GECAS provides equity seed financing to buyers of smaller planes that use GE engines, creating "commonality" considerations that encourage airlines to select similar equipment in the future, whether or not buyers have acquired future planes from GECAS. Once an aircraft manufacturer chooses to incorporate a particular supplier's engine and other elements, it tends to continue purchasing the same brand because of significant efficiencies such as the acquired knowledge, training, and the ability to use parts across a fleet. In the past, GE made known its policy to buy only aircraft that incorporated GE engines.[12]

Honeywell is a leading producer of aerospace products, including navigation equipment, non-avionic products, engines for corporate jets, and engine starters. Honeywell accounts for fifty to sixty percent of avionic products generally (although this is not a

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15-16, *available at* http://www.usdoj.gov/atr/public/international/susocp.htm. F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 521-22 (3d ed. 1990) (discussing the "Chicago arguments" that monopolies piled on top of one another produce lower, not higher, prices).

[11] GE/Honeywell, *supra* note 3, paras. 84-88.

[12] *Id.* paras. 122-33.

single relevant market). It also accounts for sixty to seventy percent of engines installed in medium-sized corporate jets in production. For aerospace equipment other than engines, Honeywell is the largest worldwide supplier, with BF Goodrich ranking second, United Technologies Corporation ("UTC") third, and Rockwell Collins fourth. UTC is Honeywell's principal competitor in the market for non-avionic products. Honeywell is the only equipment manufacturer that offers a complete range of avionics equipment. It is the leading supplier of engine controls to engine manufacturers, particularly engine starters. Although Pratt & Whitney does make engine starters, the starters are for the company's own use.[13]

GE and Honeywell agreed to merge. They filed their merger notifications with the relevant U.S. authorities, who cleared the deal after requiring a spin-off of competitively overlapping engine assets. The parties also filed their merger notification with the European Commission, which expressed the following concerns:

(1) Eliminating competition. The merger would create a horizontal overlap in engines for large regional jets and corporate and small regional jets, strengthening GE's dominant position.[14]

(2) Bundling. The merged firm, having a large line of complementary products including products in which it was dominant or near-dominant, would have the incentive to engage in mixed-product bundling. Reflecting advantages of economic integration, including the enormous financial resources of GE Capital, the merged company would probably lower the price of the bundle while raising the stand-alone price of the products sold. The competitors, which would face higher costs of capital, would be unable to lower their prices to the same extent. Although they would reduce prices somewhat, they would lose market share and the profits necessary to invest in research and development, which would eventually lead to market exit or to the termination of key market segments. Then, the merged firm would raise its prices, creating or strengthening a dominant position in the manufacture of jet aircraft engines and in avionics and non-avionics products.[15]

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[13] *Id.* paras. 84-88, 241-43, 276.

[14] *See* Press Release, European Commission, The Commission Prohibits GE's Acquisition of Honeywell (July 3, 2001) (summarizing the Commission's reasons for rejecting the merger), *at* http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?reslist.

[15] *Id.*

(3) Vertical foreclosure of competing engine manufacturers. Honeywell is an important supplier of engine controls, such as starters, to engine manufacturers. Honeywell would have had the potential to delay or disrupt the supply of engine controls, or to increase rivals' costs, strengthening GE's dominant position in engines.[16]

(4) Reciprocity[17] (using leverage to induce one's suppliers to become loyal customers), foreclosing avionics and non-avionics manufacturers from substantial business they would otherwise have won on their merits. GE Capital provides extensive financial support to its potential customers, the aircraft makers, and uses its and GE's financial power to procure exclusive supply positions for its products. GECAS uses its buying and launching platform leverage to encourage aircraft makers to shift business to GE. After the merger, Honeywell's products would similarly benefit from this financial strength, buying power, and leverage. Since airlines are relatively indifferent to component selection, they would probably shift purchases of avionic and non-avionic products to GE. Competitors would be progressively marginalized and might exit the market, creating a dominant position in avionic and non-avionic products for the merged firm.

On the facts, the Commission rejected the merging parties' claims that they lacked dominance, that they would not have power to impose bundling or use leverage, that their customers would not accept bundling, that there would be no cross-subsidization, and that competitors could outcompete the incumbent supplier by offering counter-bundles or would leapfrog GE by introducing technological improvements to their products.[18]

Given prior EU case law, the fact-finding and the European allocation of burdens, the merger would probably have run afoul of the legal standard even without proof that the merger would lead to price increases. However, after the European Commission's concerns became public and during the period of the European investigation, Americans sharply criticized the Commission's bundling theory. Invoking Cournot, Americans stated that the merger would cause prices to fall.[19] Thereafter, the European authorities

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16 *Id.*

17 This word is not used in the decision.

18 GE/Honeywell, *supra* note 3, para. 70.

19 *See GE/Honeywell: Welch Squelched*, ECONOMIST, June 23, 2001, at 61 (explaining American criticisms of the EU's decision).

stressed the reciprocity-power scenario (GE would leverage its power over engines and financing to cause aircraft makers to buy its avionics), and predicted that in the medium term the merger would degrade the competitive structure of the market and prices would rise.[20] This prong of the analysis would play a prominent role in the Commission's decision to prohibit the merger.

When the Commission issued its decision, U.S. Assistant Attorney General in Charge of Antitrust Charles James immediately issued a press release expressing his disagreement with the European Commission's analysis and conclusions. James declared that U.S. law protects consumers while the European Commission protects competitors.[21] The attorney then stated that GE/Honeywell would engage in bundling, an efficiency-promoting activity; therefore, the Commission's decision to prohibit the merger was inefficient. The Commission prohibited the merger because GE would have become too effective a competitor. European Commissioner Monti responded to James's press release with an eloquent presentation denying his charges.[22]

In the aftermath of the decision, both sides softened their rhetoric. The United States continued to maintain that the Antitrust Division analyzed the merger in the only right way.[23] European offi-

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20 *See* Press Release, European Commission, Commissioner Monti Dismisses Criticism of G.E.-Honeywell Merger Review and Rejects Politicisation of the Case (June 18, 2001) [hereinafter Monti Dismisses Criticism] (arguing that the merger would result in a "dominant" market position), *at* http://www.europa.eu.int /rapid/start/cgi/guesten.ksh?p_action.gettxt-gt&docIP/01/855|0|AGED&lg =EN&display=. *See also Welch squelched*, *supra* note 17, at 61 (noting the Commission's shift in rhetoric after widespread criticism of the bundling theory to a more general view that the merged firm would "simply be too influential in the aircraft-engines and systems businesses").

21 Press Release, United States Department of Justice, Statement by Assistant Attorney General Charles A. James on the EU's Decision Regarding the GE/Honeywell Acquisition (July 3, 2001), *at* http://www.usdoj.gov/opa/pr /2001/July/303at.htm. *See also* Charles A. James, *Reconciling Divergent Enforcement Policies: Where Do We Go From Here?*, *in* ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE 1 (B. Hawk ed., 2002) (highlighting the differences between U.S. and EU merger control regimes).

22 Monti Dismisses Criticism, *supra* note 18, at 1 ("I deplore attempts to misinform the public and to trigger public intervention ... this is a matter of law and economics, not politics.").

23 *See* William Kolasky, Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels, Address before the George Mason University Symposium (Nov. 9, 2001) (noting a sharp divergence between U.S. and European merger clearance standards), *at* http://www.usdoj.gov/atr/public/speeches /9536.htm.

cials defended their analysis within the U.S. paradigm, apparently preferring to join the issue on grounds of economics rather than on grounds of the wider European view of "harm to competition." Defenders of the decision assert that the Commission proved the merger may have raised prices over a longer term.[24] Officials on both sides of the ocean vowed to work more closely together on the harmonization of competition law, and reaffirmed their view that closer cooperation would avert inconsistent outcomes in the future.

Skeptics might question both the stance of the American authorities (the merger would be efficient) and the stance of the European authorities (the merger would cause prices to rise). One might view the Americans' conclusion—that the merger was price-lowering and therefore efficient and pro-competitive—as a neat trick. Their conclusion was based on the Cournot effect of bringing monopoly ownership of complements under joint control. *If* pre-merger GE were dominant in engines, which the U.S. authorities denied, and *if* Honeywell were dominant in avionics, which neither U.S. nor European authorities believed, *then* GE and Honeywell each would have been charging a supracompetitive price before the merger. A merged GE/Honeywell would have avoided double marginalization, stopping its own two-stage supracompetitive pricing in order to increase profits. If the theory was that Honeywell was not dominant pre-merger but that the *merger* would make it dominant (which, again, the Americans did not believe), then the argument would be that there was no need to fear that the merger would create dominance, because the combination would create incentives to curb the exploitative power that dominance confers.

In fact, despite the fact that neither GE nor Honeywell offered proof of such promised efficiencies,[25] both American and European

[24] *See* Götz Drauz, *Unbundling GE/Honeywell: The Assessment of Conglomerate Mergers Under EC Competition Law*, 25 FORDHAM INT'L L.J. 885 (2002) (asserting that the GE/Honeywell merger would allow GE to increase market share while progressively marginalizing competitors' positions).

[25] Under European law, after the Commission demonstrated that the merger created or enhanced dominance, GE/Honeywell had the burden to demonstrate that the merger was efficient. Neither GE nor Honeywell argued that it was efficient. Moreover, it appears that GE CEO Jack Welch eventually decided that the merger was not efficient for GE. The merger no longer made economic sense, for Honeywell's economic prospects had deteriorated and the negotiated purchase price was high. Perhaps as a result, Welch failed to offer the conditions that the Commission signaled would be acceptable. Press reports indicated that Welch

authorities asserted that GE/Honeywell would lower its prices after the merger. The United States and the European Union simply came to different conclusions. The United States argued that the lower prices would trigger more competition; European authorities insisted that the merger would be price-*raising* after a siege of low pricing. They argued that prices would rise not in the short-term, but in the medium-term, as the competitive structure of the market weakened and the less advantaged competitors disengaged from the sectors in which GE/Honeywell had preferential access to customers. Normally, it is difficult to predict a medium-term price rise in the aftermath of low pricing. Low-price competition normally triggers competitive responses from rivals. An analysis of the many variables in play would usually moderate a prediction that low prices would squeeze out or divert all significant competitors, rather than toughen them up; barriers would keep out entrants in the face of a later rise in prices, even if such a scenario were possible under special circumstances.[26]

After the initial conflict, the warring authorities regained their optimistic cooperative stance. Future clashes would be rare, they said. The world needs convergence, and the trend-line towards convergence is strong. A major case decided by the European Court of First Instance ("CFI") in the summer of 2002 reinforced the trend line. The Commission had decided to prohibit the merger of British holiday packagers Airtours and First Choice on grounds that the remaining firms in the market would gain "collective dominance." The CFI annulled the decision on grounds that the Commission had not proved that the rivals would change their behavior to act collectively (in a cartel-like fashion). The market conditions necessary to facilitate collective action were not present.[27] Airtours effectively raised the standard of proof facing the Commission by subjecting the Commission's economic fact-finding to intense scrutiny. Airtours, however, does not concern itself with the possible exclusionary or foreclosing effects of a

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was content to walk away from the deal. *Welch squelched*, *supra* note 17, at 61 (stating that "Mr. Welch made remarks that killed any scope for further negotiation.").

[26] *See* Robert J. Reynolds & Janusz A. Ordover, *Archimedean Leveraging and the GE/Honeywell Transaction*, 70 ANTITRUST L.J. 171 (2002) (arguing that the necessary conditions for a medium-term price increase were present in the GE/Honeywell case).

[27] Case T-342/99, Airtours Plc. v. Commission (2002), *available at* http://curia.eu.int/common/recdoc/indexaz/en/t2.htm.

merger, which remains a subject of greater divergence among national systems.

4. WHERE DO WE GO FROM HERE?

The gaps and overlaps that stem from application of national laws to mergers in global markets are evident. Policymakers tend to pose one of two alternative questions as their starting point when considering solutions to the problems with today's system: (1) What tools of resolution are at our fingertips?, or (2) How can we bring competition law in line with global markets and make the world trade-and-competition system more rational and seamless?

Those who ask the first question would observe that networks of cooperation have formed, and they are growing. Bilateral networks do exist. U.S.-EU cooperation is prime among such networks. Cooperation in the analysis of particular mergers of common interest is particularly strong, with staff consulting regularly. Meetings of the Competition Law Committee and Global Competition Forum of the Organisation for Economic Cooperation and Development (OECD), and the newly formed International Competition Network (ICN), strengthen the effort. The networks, and the communications and alliances they spawn, drive the law towards greater convergence.

Moreover, the law on extraterritorial jurisdiction has sufficiently converged so that it is possible for nations, with some claim of legitimacy, to catch and reprehend conduct and transactions that occur beyond their borders but have significant effects within the territory.

Will horizontal (nation-to-nation) networks and legitimate extraterritorial exercises of jurisdiction substantially solve the problems of applying national law to transactions in a global world? Is *GE/Honeywell* the rare exception or the significant example? *GE/Honeywell* is exemplary of systemic problems that are of significant dimension, even while competition authorities are sure to exercise restraint before allowing another public confrontation. Neither cooperation nor isolationism can provide sufficient and legitimate answers.

First, in matters of exclusionary practices, there is a perceptible gap between the conceptual underpinnings of the laws of different nations. These foundations may shift from time to time, but not always in the same direction at the same time.

Second, national authorities and courts consider only the benefits and harms within their own borders; nations act nationalistically. Although antitrust authorities are relatively well-motivated and well-trained to apply principles of national treatment and nondiscrimination, this applies to inbound commerce, not outbound harms. One may wonder if it is mere coincidence when a nation's antitrust decisions align with the nation's political interests. For example, a national government might support a merger between its nationals, as the United States did in Boeing/McDonnell Douglas.[28] When a merger of foreign nationals would create a firm that threatens to outcompete the jurisdiction's champion (e.g., a yet larger Boeing competing against Airbus Industrie), is it, again, mere coincidence when Europe's competition policy and its industrial policy align?[29] Even if such circumstances arose out of mere coincidence, the conflict of interest erodes the grounds for trust.[30] There is need for an impartial decision-maker, in appearance as well as fact.

Third, there is an increasingly pressing need for a party with a perspective that can encompass a whole problem. National level is the wrong level from which to judge an international merger. If neither Ohio nor New Jersey were the appropriate level at which to conceptualize and challenge Standard Oil's conduct and acquisitions in the United States in the early 1900s,[31] and if neither France, Italy, nor Germany would have been the suitable level at which to conceptualize and approve or prohibit the ATR-de Havilland acquisition in the early 1990s,[32] then neither the United States nor the European Union is at the best level (or jurisdiction) to permit or prohibit a Boeing/McDonnell Douglas or a GE/Honeywell. Global markets demand globally-conceptualized law.

This conclusion invites the question: How can we bring competition law into line with the true breadth of markets?

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[28] Boeing Co., 5 Trade Reg. Rep. (CCH) ¶ 24,295 (July 1, 1997).

[29] Case IV/M.877, Boeing/McDonnell Douglas v. Commission, 1997 O.J. (L 336) 16.

[30] *See* Editorial, *Who Asked Europe?*, WASH. POST, July 24, 1997, at A20 (discussing merger interference by the United States and other countries).

[31] *See* United States v. Standard Oil Co., 221 U.S. 1 (1911) (applying the Sherman Act).

[32] *See* Case IV/M.053, Aerospatiale-Alenia/de Havilland v. Commission, 1991 O.J. (L 334) 42, [1992] 4 C.M.L.R. M2 (blocking a proposed merger between French and Italian companies with a Canadian division of Boeing).

The challenge is a difficult one—difficult politically, because nations see a loss of sovereignty when law is taken out of their hands; difficult practically, because there is the need to formulate a principle of law and a method of enforcement or surveillance. However, the obstacles to international merger regulation are not insurmountable. If higher or more cosmopolitan law makes sense, the law will find its appropriate level, just as U.S. law did in 1890 and European law in 1957. This does not mean that we must move to a federal world. The European measure known as a framework directive is a helpful model.[33] According to the model, nations might agree to a framework for addressing global market problems. The agreement can specify general principles: for example, no anticompetitive mergers with significant negative external effects, subject to possible transparent and proportional derogation. It can be left to the participating jurisdictions to meet the objectives of the framework measure by formulating and making transparent a national rule and applying their national rule to the whole geographic market unbounded by artificial borders.

Thus, if jurisdictions agree to a multilateral principle against anticompetitive mergers, an enforcing jurisdiction, applying its own formulation to an international merger, could be required to adopt and enforce measures carrying out the principle and in doing so to take account of all market harms, including those beyond its territorial borders. Extraterritoriality would thus become a two-way street with a cosmopolitan dimension. Not only could a nation challenge acts abroad that hurt its citizens, but it could also protect those abroad hurt by its citizens. If national authorities cannot accept this mantle of cosmopolitanism (and ultimately perhaps even if they can, for the conflict of interest problem is not cured), then a world-level panel for judicial resolution of clashing national decisions may be the necessary next step.

World-level antitrust is a vision for the future; it will not come tomorrow. However, the mind that takes seriously the problems exemplified by GE/Honeywell and the limits of national laws when applied to global transactions is led ineluctably in this direction.

[33] *See* G. BERMANN ET AL., EUROPEAN UNION LAW, CASES AND MATERIALS 75-76, 572 (2d ed. 2002) (exploring a new method through which a smaller number of directives are adopted as frameworks).