THE DECISION GENERAL ELECTRIC/HONEYWELL EXPLANATION OF THE PRINCIPLES THAT LED TO THIS DECISION

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The Decision General Electric/Honeywell – Explanation of the Principles that led to this Decision
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Abstract

On 3 July 2001 the European Commission declared the proposed merger between *General Electric* and *Honeywell* incompatible with the common market (Commission, Decision of 3 July 2001, Case no COMP/M.2220).

It was the first interdiction of a merger of two US companies by the European Commission where the US authorities had previously allowed it. The main reason for this contradiction is the different perception of the concept of market power. As the merging companies produced complementary goods, the merger led to a decrease of prices. In the US an increase of market power is tolerated if the consumers profit of lower prices. The EC-concept condemns an increase of market power irrespective its consequences.

This thesis aims to explain this conceptual difference by analyzing the EC-system of competition law.

2001 Temmuz'unda Avrupa Komisyonu General Electric ile Honeywell arasındaki birleşmenin ortak pazara aykırı olduğunu ilân etmiştir (3 Temmuz 2001 tarihli Komisyon Kararı, Dava no COMP/M.2220).

Bu karar Avrupa Komisyonu'nun ABD otoritelerinin önceden onayladığı iki ABD menşeili şirketin birleşmenin ilk kez yasaklanmasıydı. Bu çelişkinin en önemli nedeni piyasa hâkimiyeti kavramının farklı algılanmasıdır. Birleşen şirketler birbirini tamamlayan mallar ürettikleri için birleşme fiyatların düşmesine neden olur. ABD'de piyasa hâkimiyeti tüketicilerin düşük fiyatlara ulaşmasını sağlıyorsa hoşgörülebilir. AT'de ise piyasa hâkimiyetinin artması kavramı sonuçlarına bakılmaksızın kâbul edilmez.

Bu tez AT rekabet hukukunu inceleyerek kavramsal farklılığı tanımlamayı amaçlamaktadır.

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1. Introduction

On 3 July 2001 the European Commission declared the proposed merger between *General Electric* and *Honeywell* incompatible with the common market (Commission, Decision of 3 July 2001, Case no COMP/M.2220).

This decision is interesting in two respects:

First: it was the first interdiction of a merger of two US companies by the European Commission where the US authorities had previously allowed it. Although in recent years a harmonization between EC and US law in the field of merger control could be noticed, contrary decisions were taken by EC and US authorities, notwithstanding the fact that there was no difference in respect to the effects of the merger on the two geographical (EC and US) markets.

Second: the goods produced by the main protagonists are complementary. Therefore the merger would have led to lower prices. Although a decrease of prices is generally seen as a positive effect for market and competition it led the Commission to block the intended merger.

In order to explain the interest of those two aspects of the decision, I will at first summarize the facts of the case and the reasoning of the Commission. Then I will give an overview over EC Competition Policy with special regards on merger control. In the end I will compare the reasoning of the Commission to the findings from the overview to reach the conclusion in the end.

2. The Case – *General Electric/Honeywell*

2.1. Facts of the case

General Electric is a diversified industrial corporation active in fields including aircraft engines, appliances, power systems, information services, lighting, industrial systems, plastics, medical systems, broadcasting, financial services and transportation systems. One of the subsidiaries of *General Electric* is *General Electric Capital Aviation Services (GECAS*), the biggest global buyer of commercial aircrafts.

Honeywell is an advanced technology and manufacturing company serving customers worldwide with aerospace products and services, automotive products, speciality chemicals, electronic materials, performance polymers, transportation and power systems as well as home, building and industrial controls.

Both companies are US-American entities. Their fields of production in respect to aircraft technology hardly overlap; therefore they produce complementary goods for the aircraft markets.

In October 2000 they set up an agreement to merge and notified the planned merger to the European Commission in February 2001.

On 2 May 2001 the US-Department of Justice (US competition authority) allowed the merger imposing a few conditions, stating that the merger will promote competition and have a positive impact on the customers because of the availability of cheaper and better products.

On 3 July 2001 the Commission declared the proposed merger incompatible with the common market.

2.2. Findings of the Commission

As the two parties of the planned merger act worldwide and their turnovers inside the European Community exceed the thresholds for the Merger Control Regulation (4069/89) the Commission decided to have jurisdiction over the matter. After having defined the relevant markets and in their product and geographical dimensions the Commission analyzed the position of the two entities inside these markets and the impact of their merger on competition in these markets.

The Commission observed that *General Electric* was already in a dominant position on the markets for engines for lager commercial and large regional jet aircrafts because of its high and increasing market shares, its vertical integration into aircraft purchasing, financing and leasing through *GECAS*, its financial strengths through *GE Capital* (another subsidiary) and its strong position on the aftermarket services (repair shops etc.). Due to that position *General Electric* can take more risk in product development programs than any of its competitors. This is a very important factor because the aircraft industry is characterized by long term investments and therefore product failures are not at all easily absorbed by *General Electric's* smaller competitors.

Furthermore, due to its financial position, G*eneral Electric* had been able to give heavy discounts on the initial sale of the engines and to provide significant financial support to airframe manufacturers.

The Commission also found that in the markets of avionics (equipment for the control of aircrafts, their navigation and communication and for the assessment of flying conditions), non-avionics and engine starters *Honeywell* was the market leader.

The only field where *General Electric* and *Honeywell* compete is the market of small marine gas turbines.

Following the Commission's reasoning the proposed merger would have led to the creation/strengthening of dominant positions of several markets as a result of horizontal overlaps between some of the parties' products and the combination of *Honeywell's* leading market positions with *General Electric's* financial strength and the vertical integration in aircraft purchasing, financing, leasing and aftermarket services. Although this could lead to a decrease in prices and an increase of quality of the products, it would impair competition in the EC market.

The merger would also put the parties in a position where bundling/tying of complementary goods (everything you need to build an aircraft) and other uncompetitive measures are possible more easily.

Although *General Electric* proposed a number of undertakings in order to save the transaction, the Commission – not accepting the proposals as being no sufficient remedy – decided that proposed merger between *General Electric* and *Honeywell* incompatible with the common market.

3. European Competition Law – General Overview

3.1. Economical Background – Competition and Price Finding

3.1.1 Prices in Perfect Competition

Perfect competition is defined as follows (*Maurice, S. Thomas, C.*, Managerial Economics[7], 18 and 428; http://en.wikipedia.org/wiki/Perfect_Competition):

- There are a lot of suppliers and customers in the market.
- None of the participants in the market reaches a specific size.
- There is absolute transparency of market transactions.
- Products are homogeneous, goods and services are interchangeable, they are perfect substitutes.
- Every participant has access to necessary resources.

Under these circumstances – which only exist in theory – the possible maximum number of products is produced at lowest possible cost, and goods and services are sold at minimum price.

In order to reach a situation resembling to this, there have to be suppliers who are independent from each other and put pressure on their competitors.

In perfect competition neither suppliers nor consumers have the power to influence the prices. The price sets itself at the point where supply meets demand at the equilibrium. The participants in the market are so called „price takers". Thus they must take the price that the market dictates.

In reality the perfect competition is *inter alia* disturbed by the fact that bigger producers can produce at a lower price and therefore more efficient than small ones, because transaction costs and information costs can't be zero in reality as supposed under the model (http://en.wikipedia.org/wiki/Perfect_competition). This problem takes more and more interest in European competition policy.

In perfect competition the marginal costs are at the same level as the marginal price. Therefore none of the suppliers makes profit. In order to make profits the producers have to make innovation (better products, better design, new features etc.). At the moment of the new market entrance of the better product this product has the position of a monopoly, but soon loses this position due to imitation by other producers (e.g. iPod).

Perfect competition therefore leads to higher quality of the products (including innovation), lower prices and a great variety of goods. In order to obtain these advantages and benefits, the European Community has amongst its goals to ensure effective competition on the EC market.

3.1.2 The monopoly

The term monopoly comes from Greek „*monos*“ (single) and „*poliein*“ (to sell).

The term describes the situation where there is only one supplier or only one consumer in the market and therefore controls the price on that market, but also where there are more than one suppliers but one of them is so big that it is the only one who can interfere in the price building mechanism (http://de.wikipedia.org/wiki/Monopol).

As running a monopoly/being a monopolist means making profits, one of the goals of a monopolistic producer is to prevent possible competitors from entering the market. This often leads to dumping, illegal cooperation, price fixing etc. These remedies are often in breach of national or supranational competition acts and rules. Another of these breaches is misuse of the market position (*Maurice, S., Thomas, C.,* Managerial Economics[7], pp 580).

Generally monopolies are seen as a negative thing. They slow down innovation and are not efficient, because they don't have to gain the short time better positions vis-à-vis their competitors by creating a higher value of their product for the consumer by creating new and better models of their product. In perfect competition also cost advantages are of great importance because cost is a vital variable for the producer in order to be able to stay on the market. In a monopoly situation the monopolist doesn’t feel the pressure to lower production and other costs in order to be able to supply at a cheaper price.

Another problem are the difficulties to enter a monopoly market, therefore potential competitors who would produce the same product but with innovations, restrain from producing the respective products. This leads to a loss of innovation (www.de.wikipedia.org/wiki/Monopol).

In cases where there is only one supplier of a certain product in the market, the price at which the product is sold is usually not the market price. The supplier will try to influence the market price in order to increase his profit by setting a higher price for a product of lower quality than it would be in perfect competition. This doesn't mean that the supplier can set any price he wants but only the highest price consumers would pay in the market for that product. This means that the consumers' demand limits the price for the monopoly producer (*Varian, Hal R.*, Intermediate Microeconomics[5], A Modern Approach, 414).

For a monopoly supplier's most efficient price-quantity relation the price is higher and the produced quantity is lower than in perfect competition.

In addition to this there is a deadweight loss. This is the difference between the marginal costs and the paid price. From this difference only the producer benefits, therefore in a monopoly (or oligopoly) the profit of the consumers in a perfect competition goes to the producer. The other part of the deadweight loss is the lost quantity of the good that is produced by the monopolist in a smaller quantity. From this difference neither the producer nor the consumers benefit.

Because of the deadweight loss, where profit is lost for the supplier and the consumer, from an economic point of view the monopoly has to be qualified as inefficient.

3.1.3 Oligopoly (*Maurice, S., Thomas, C.,* Managerial Economics[7], pp 527, www.net-lexikon.de/Oligopol.html):

The other problematic situation besides the monopoly is the oligopoly.

In an oligopoly there are either a small number of suppliers and many consumers – then it is an oligopoly of supply – or a lot of suppliers and very few demanders – that is an oligopoly of demand.

Regarding the number of the suppliers, there are wide and narrow oligopolies.

Supplier oligopolies show absolute transparency of the market, because producers know the demand situation and also their competitors. Besides that the prices are known to each competitor.

There is only a small number of competitors. They know that they are dependent from each other. Therefore each competitor in an oligopoly situation plans his activities on the basis of the decisions of his competitors or what he supposes their decisions will be.

But the oligopolist lacks influence over the decisions of his competitors. Therefore the actors on an oligopolist market tend to coordinate their activities by agreements, which are disadvantageous for the consumers. Therefore competition law has to prevent such coordination in order to keep the real market prices and quantities (lower prices and higher quantity) in order to prevent producers from taking away profits from the consumers.

Oligopolies also lead to the creation of „brands“, which tell the consumer that products are different from other products but in fact are not.

3.1.4 Consequences

As producers/suppliers try to maximize their profit and their profit is bigger in the second and third model (monopoly and oligopoly) there are different strategies (*Schmidt, Ingo*, Wettbewerbspolitik und Kartellrecht[6], Eine Einführung, pp 118):

The first one is the agreement strategy. Competitors try to make agreements amongst each other in order to reach a situation similar to a monopolistic or an oligopolistic situation. Such agreements can be made horizontally. This means that suppliers of the same level (e.g. both supplying beer in bottles) are factually coordinated or make agreements (cartels) in order to distribute the market or fix prices etc. But there are also agreements on the vertical level, which are namely license agreements or price regulations.

The second one is the prevention strategy. Suppliers try to harm their competitors on a factual and legal basis by exclusivity terms, boycott, refusal to supply or discriminations on the price level.

The third strategy is concentration. Competitors try to grow or merge horizontally, vertically or diagonally.

The necessity for merger control results from the third strategy. Concentration is the reduction of the number of economical subjects in a market. This can be caused or made easier by legal frameworks, incomplete market of capital, advantages of being bigger, agreements and other measures to reduce competition, patents, science and development, advertising etc. (Monopolkommission, 4. Hauptgutachten 1980/81: Fortschritte bei der Konzentrationserfassung, Kap. VI: Ursachen der Konzentration).

Mergers and acquisitions can take place horizontally, between subjects of the same market level. This leads to reduced competition by allowing greater influence between the merged subjects.

They can also take place vertically, if the subjects don't belong to the same market level. This is to ensure supply and disposal.

Other mergers are diagonal or conglomerate, which means that they are neither on the same market level, nor connected by supplying each other. Diagonal or conglomerate mergers can for example take place between to companies producing complementary goods. The *General Electric/Honeywell* case is an example for a merger of two companies producing complementary goods on the market. The reason behind such a complementary merger is to be able to adapt the products to each other and develop them in connection to each other. This can increase quality. But this can also lead to the reduction of competition because of the reduction of pressure (*Schmidt, Ingo*, Wettbewerbspolitik und Kartellrecht^6, Eine Einführung, pp 138).

Competition law – especially merger control – tries to reduce the negative effects of concentration.

3.2. Remedies against these problems in European Competition Law

(*Schmidt, I., Schmidt, A.*, Europäische Wettbewerbspolitik, pp 18)

3.2.1 Basic Principles of European Competition Law

The goal of European competition policy is to grant functioning and effective competition within the European Single Market and to establish and develop competition in sections where there is not yet a functioning competition.

Deriving from Article 4 of the EC Treaty the main goal of the Commission is to grant a working Single Market with free competition.

"Article 4

1. For the purposes set out in Article 2, the activities of the Member States and the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition."

Competition leads to lower prices for the consumers, higher quality of the produced goods, a greater choice amongst goods and services and innovation. The cause for this is that the products that are sold on the market have to compete against their competitors and therefore have to match with the needs and expectations of the consumers. There, price, quality, innovation and extra features play an important role. On the other hand the consumers have the choice between different suppliers and can choose the products which match best with their needs.

Therefore every supplier tries to make the best relation between price and product for his customer, thus prices are kept low and the producers try to minimize production costs. (European Commission, Competition Policy and the Citizen, www.europa.eu.int/comm/competition/publications/competition_policy_and_the_citizen/de.pdf)

Already in 1957 in the Treaty of Rome Article 3 lit g provided:

"Article 3

(...) the activities of the Community shall include (...)

(g) a system ensuring that competition in the common market is not distorted;"

This provision was made applicable by the introduction of Articles 85 to 94 EC Treaty. The first Merger Control Regulation was released in 1989.

With the Treaty of Amsterdam the numbers of the treaty provision changed and Articles 85 to 94 were now 81 to 89. These provisions should prevent obstacles to free competition amongst the member states. This doesn't forcibly mean that the competition must be disturbed between at least two member states in order to fall within these provisions. The inter state component has been rendered more or less void by the European Court of Justice, who stated that any measure, which directly or indirectly, actually or potentially distorts trade between member states in a recognizable amount, and this distortion is disadvantageous for the goals of the Single Market, because obstacles to trade are established or stabilized, falls within the provisions.

Thus certain measures leading to the situation just described are forbidden; the opening of the Single Market shall not be distorted by distribution of the market between few private enterprises or misuse of strong market positions.

Therefore the market has to be controlled in order to grant fair competition.

3.2.2 Contents of European Competition Law

Articles 81 to 89 foresee

- prohibition of agreements distorting competition,
- misuse of strong market positions,
- merger control,

- disappearance of still existing monopolies, especially in market sectors that have long been controlled by the state,
- control of state aid.

Measures only fall within these provisions if they (directly or indirectly, actually or potentially) distort trade between member states. If such measures are only of a national dimension national competition laws are applicable.

Except for Articles 81 and 82 of the EC Treaty, where the Commission cooperates with national competition authorities, the organs of the EC have exclusive competence, especially concerning state aid and merger control.

Articles 81 and 82 and the merger control regulation contain a lot of provisions allowing the Commission to investigate financial, technical or business situations. But it has been established that if these fundamental enquiry measures are carried out, each party has a right to explain their point of view and business secrets are respected.

In order to secure consequences of the Commission's investigations the Commission is competent to order sanctions against measures distorting competition. The Commission mainly applies orders to omit such measures and pecuniary fines, or interdicts mergers. Pecuniary fines can amount to 10 per cent of the global turnover of the company in question. In the *Hoffmann-La Roche* case a fine of DM 732.000,- (EUR 366,000,-) was ordered for three years of distortion of competition. In *Tetra Pak II* the fine was 75 Million Euro, and in the 1998 *Volkswagen AG* decision the fine was 102 Million Euro; this fine was subsequently mitigated to 90 Million Euro. There are extenuating and aggravating causes, which especially influence the amount of the fines.

3.2.3 Procedures

Article 9 of Regulation 17/62 (now regulation 1/2004, Article 4) provides that the Commission is the guardian of Articles 81 and 82 of the EC Treaty. The provision establishing the Commission's competence for competition measures is Article 211 EC Treaty. This competence contains the decision making in competition matters as well as the execution of these decisions.

The advantage of this competence of the Commission is that a homogeneous application of the competition provisions is granted throughout the European Community.

The Commission's respective Directorate General (DG Competition) has 9 subdivisions, from Policy and Strategies to Task forces for merger control and state aid.

In Regulation 17/62 (now regulation 1/2003) the procedural rules for the application of articles 85 and 85 (now 81 and 82) were set up. Its Article 10 (2) provided for cooperation between the Commission and national authorities. The national authorities had the right to get all relevant documents and make declarations about them. On the other hand they had to assist the Commission to obtain data (*Schmidt, I., Schmidt, A.*, Europäische Fusionskontrolle – Eine Einführung, pp 95).

In order to ensure this cooperation, Regulation 17/62 provided for a committee for cartel and monopoly questions. This committee contained members of national competition authorities and was to be heard before each decision. It had the right to make declarations on planned measures of the Commission but these declarations were not legally binding and the Commission could decide otherwise.

In spite of that the committee worked very efficiently. Therefore Regulation 1/2003 provides for new powers of the committee.

The Merger Control Regulation No 4064/89 of 21 December 1989 (now Regulation No. 139/2004 of 20 January 2004) also provided for an Advisory Committee in its Article 19 (3). This merger control committee also consists of members of the respective national authorities. Unlike the declarations of the committee for cartel and monopoly questions the statements of the Merger Control Committee are obligatory. As the Commission has a strong interest in following these statements, the influence of national competition authorities in questions of merger control is very strong. But still the declarations of the Merger Control Committee are not legally binding.

3.2.4 Article 81 of the EC Treaty (ex Article 85)

"Article 81

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- *any agreement or category of agreements between undertakings,*
- *any decision or category of decisions by associations of undertakings,*
- *any concerted practice or category of concerted practices,*

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

Generally interdicted by EC law are therefore agreements that distort the functioning of the market. These agreements concern e.g. price fixing, the limitation of production or the distribution of markets. Their impact on competition is bad and they can lead to disadvantages of the other market participants.

Seen as a whole these measures prevent innovation and variety of products, because the companies don't have to supply a better (more innovative or special featured) product than their competitors. At the same time these companies don't have to minimize production costs in order to obtain price advantages. The consumer has to pay more for the goods and loses his choice amongst different products and prices. Furthermore the national as well as the supranational economy get competition disadvantages on the international market because of loss of investment and interest in research and development.

Thus uncompetitive measures by some companies harm all the market participants, therefore the intervention by public authorities is legitimate. On the other hand, companies making this kind of illegal agreements not discovered by public authorities are in the long run not save from fall of prices. The risk of a potential new competitor entering the market rises, if the market offers a high price level and therefore a chance of big profit.

In the years 1997 to 2000 the Commission made more than 400 decisions about agreements impairing competition. (European Commission, Competition Policy and the Citizen, www.europa.eu.int/comm/competition/publications/competition policy_and_the_citizen/de.pdf)

3.2.5 Article 82 of the EC Treaty (ex Article 86)

Article 82

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

This article prohibits the misuse of a dominant position in the Single Market or on a substantive part of it by one or more companies, if it is capable to distort trade between Member States.

One important factor of this provision is having a dominant position. But this alone doesn't constitute a misuse. Only if an enterprise in a dominant position uses its power in order to distort or disturb competition, it constitutes a misuse. Article 82 (and Regulation 17/62 – now Regulation 1/2003) provides for a system to investigate this misuse and order sanctions. Examples for such misuse of a dominant position are

- direct or indirect coercion of unjust buying or selling prices or other business terms (*United Brands*, ECJ 14 February 1978, Sacchi, ECJ 30 April 1974),
- exclusive supplying or acceptance duties (e.g. *Hoffmann-La Roche*, ECJ, 13 February 1979; *AKZO*, ECJ 3 July 1991),
- denial of supply (*United Brands*, ECJ, 14 February 1978),
- application of different terms to similar performances vis-à-vis different business partners in order to cause disadvantages in competition for them (*Hoffmann La-Roche*, ECJ, 13 February 1979), or

- conditions linked to contracts pushing the other contracting party to accept duties that otherwise had no connection to the contract (e.g. *Suiker Unie*, ECJ, 16 December 1975; *United Brands*, ECJ, 14 February 1978).

In order to define the term “dominant position” the Commission uses the same criteria as in merger control. It is defined as follows:

A dominant position is the economical power of an undertaking that enables the undertaking to impede the functioning competition on the relevant market by being able to act independently from its competitors and purchasers including the consumers.

This formula has become the standard (*Von der Groeben, H., Schwaze, J.,* Kommentar zum Vertrag über die Europäische Union und zur Gründung der Europäischen Gemeinschaft^6, Vol. 2, Art. 81 -97 EC Treaty, Nr 71) and was formulated at first in the *United Brands* Case (ECJ 14 February 1978).

“The dominant position referred to in this article relates to a position of economic strength enjoyed by an undertaking which enables it 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, customers and ultimately of its consumers.”

If an undertaking is in such a dominant position it could misuse this position in the sense of Article 82 EC Treaty and increase its profits, establish an even better position on the market and try to knock out its competitors or prevent new competitors from entering the market. This leads to higher prices, lower quality and worse terms of business (European Commission, Competition Policy and the Citizen, www.europa.eu.int/comm/competition/publications /competition_policy_and_the_citizen/de.pdf).

3.2.6 Merger Control

Mergers, Acquisitions or Founding of companies are from an economic point of view generally seen as positive. They lead to lower production costs by rationalization, and to more efficiency. Another consequence is a bigger budget for research and development what can lead to developments causing big economic profit that wouldn't have been reached by the former small undertakings. Consumers pay less because of lower production costs. Because of the pressure in competition and these mentioned advantages, in recent years more and more mergers take place in the European Union (European Commission, Competition Policy and the Citizen, www.europa.eu.int/comm/competition/publications/competition_policy_and_the_citizen/de.pdf).

The provisions of the EEC Treaty concerning competition (ex Articles 85 and 86) initially didn't contain rules for merger control.

Regulation 17/62 (now Regulation 1/2003) which laid down rules for the application of these provisions didn't contain special provisions on merger control either.

Feeling the lack of these provisions the European Court of Justice stated for the first time in the *Continental Can* decision (ECJ, 21 February 1973) that a merger can constitute a misuse of a dominant position in the sense of Article 86 (now Article 82) and applied the provision to a merger.

The case was about a merger of enterprises in the packaging industry. The central question of this case was to establish, whether the *Schmalbach-Lubeca AG* (*SLW*), a German subsidiary of *Continental Can*, held a significant share of the European market for special packaging materials (cans and metal closures for glass packaging) or not. In April of 1970 *Continental Can* already held 80 per cent of the shares of *TDV*, a BeNeLux Company and only other producer of packaging in the European

Community and therefore only competitor of *SLW*. This transaction would have eliminated competition completely from this sector.

The primary question in this case was the one about the relevant market.

Following the Commission the ECJ in this case considered the relevant market to be „the market for light containers for canned meat products", „the market for light containers of canned seafood" and „the market for metal closures for the food packing industry, other than crown corks". It stated that the domination of this market by *SLW* and the alleged merger led to a total elimination of competition there. Although following the ECJ the Commission hadn't given a clear reasoning as to the differences between these three markets or the difference of these markets to the market of metal containers for fruit and vegetables, condensed milk, olive oil, fruit juices and chemico-technical products, the ECJ upheld the decision of the Commission by stating that cans for meat and fish differ from other packaging in technical manners. As long as the (potential) competitors are not able to enter the relevant market by a simple adaptation of their products with sufficient strength to create a serious counterweight to the new company, the market must be regarded as a separate one.

Unlike the Commission the ECJ negated the dominant position of the respective companies on the relevant market and annulled the Commission decision. Nevertheless the *Continental Can* decision was a milestone in merger control because the ECJ agreed with the commission that a merger leading to or extending a dominant market position can constitute a misuse of a dominant position in the sense of Article 86 (now 82) of the EC Treaty, especially if it eliminates competition for the respective goods in a relevant part of the Single Market.

Summarized the ECJ considers that any extension of a dominant market position – irrespectively its causes – constitutes a potential misuse, if competition is limited in such a way that only companies remain on the market which are dependent on the dominant enterprise. This reasoning was also followed in the *Wilkinson/Sword* decision (Commission decision of 10 November 1992):

An undertaking in a dominant position has a special responsibility not to impair the competition on the market. By overtaking *Wilkinson Sword Gillette* didn't satisfy this special responsibility and therefore misused its dominant market position. *Gillette* acted as the driving force in this transaction. In spite of all diligence in the formulation of the agreements, the market of wet shaving devices has been impaired by the corporate integration between *Gillette* and its major competitor.

As long as merger control had to be based on Article 86 (now 82) of the EC Treaty, it was only possible under special circumstances and only *ex post*, so to say when the merger had already taken place. Therefore the Commission already made a proposal for a merger control regulation in 1973. But it took 15 more years until the first Merger Control Regulation came into force.

While the Commission tried to enact a Merger Control Regulation there were alternative attempts to apply Article 85 (now Article 81) of the EC Treaty to share deals (e.g. ECJ, *Philip Morris*, 17 November 1987). The ECJ stated that Article 85 (now Article 81) EC Treaty only applies to agreements that are used as tools for influencing market behavior by share deals etc. The danger of application of Article 85 (now 81) EC Treaty to mergers also contributed to the enactment of the Merger Control Regulation 4069/89, while the possibility of application of Articles 81 and 82 EC Treaty remains in question (*Schmidt, Ingo,* Die Europäische Fusionskontrolle – eine Synopsis, pp 9).

It is certain that Articles 81 and 82 EC Treaty don't ensure a sufficient control for all types of mergers and give a comprehensive protection of competition.

The Merger Control Regulation 4069/89 has been in force since 1990. The quantitative thresholds have been adjusted in 1997. With the Treaty of

Amsterdam the European Parliament was granted a right to hearing in competition matters and the quorum of the Council in competition matters was brought down from unanimity to qualified majority. In 2004 the Merger Control Regulation was reenacted (Merger Control Regulation 139/2004 of 20 January 2004).

3.2.7 Development of the new Merger Control Regulation

The Merger Control Regulation 4069/89 and the practice of the Commission based on that Regulation was criticized more and more, especially since 1999. Important points were

- that the Commission had interdicted 8 mergers between 1999 and 2001 while in the 8 previous years only 10 mergers weren't approved;
- that there was no coherent system of anti trust theories applied by the Commission but a very obscure mixture of theories;
- that the commission detected a dominant position where the market share of the respective undertakings after the merger was less than 40 per cent;
- that the procedural rules of the regulation were applied very stringently and therefore corrective measures of the concerned companies often came to late;
- that the flexibility of the Commission in merger control matters had decreased due to increasing workload;
- the role of the Commission as investigating, prosecuting and deciding authority at the same time (*Levi, Nicholas*, EU Merger Control: From Birth to Adolescence, pp 207).

In 2001 the Commission issued a Green Paper on the reformation of the Merger Control Regulation which finally led to the new Merger Control Regulation 139/2004.

The old regulation provided for a dominance test. The Commission had to establish whether the merger led to a single or collective dominant position (more than 50 percent market share) and an increase in the market price was to be expected. These criteria were very imprecise and also inaccurate.

In the new regulation the criteria for interdiction is a “significant impediment to effective competition”. The test to establish this condition is mainly based on economical analysis as described in the Green Paper. The Commission can intervene also in situation where there is no dominant position but nonetheless “non-collusive oligopoly effects” are to be expected. On the other hand, the Commission can’t interdict mergers that lead to a dominant position of the new entity but have no negative impact for the consumers.

Also the procedural rules were amended in order to give the applicants more time to develop counter measures against the distortion of competition in order to be able to carry out the merger.

The Merger Control Regulation had a great impact on national Merger Control Acts and therefore led to a more or less harmonized standard of merger control in the Member States (*Oberender, P.* (Ed), Die Europäische Fusionskontrolle, p 69).

3.2.8 The Merger Control Regulation in Detail

Definition of Merger:

The term “undertaking” has been defined by the ECJ as any entity carrying out an economic activity irrespective its legal structure or financing (ECJ, *Höfner and Elser*, 23 April 1991).

Concentration:

The term "concentration" has been defined by the Commission in the regulation, especially in the preliminary considerations thereof. "Concentration" is any operation that leads to a permanent alteration of the structure of the involved undertakings. Mergers and acquisitions generally fall within this definition, whereas a merger is a fusion of two (or more) formerly independent undertakings, and an acquisition is the obtaining of control by one undertaking over another due to a share or asset deal.

Community dimension – competence of the Commission

The Commission is only competent to consider the concentration, if the transaction has a "Community dimension".

"Community dimension" is defined by the Merger Control Regulation. According to Article 1 paragraph 2 of the Merger Control Regulation 139/2004 a concentration has a Community dimension where

- the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5000 million and
- the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million,
- **unless** each of the undertakings concerned achieves more than two thirds of its aggregate Community-wide turnover within one and the same Member State.

If these criteria are not met, paragraph 3 of the Article provides for another 4 requirements. If these are fulfilled the concentration is also of a "Community dimension":

- the combined aggregate worldwide turnover of all the undertakings concerned has to be more than EUR 2500 million,

- in each of at least three Member States, the combined aggregate turnover of all the undertakings has to be more than EUR 100 million,
- in each of at least the above mentioned three Member States the aggregate turnover of at least two of the undertakings concerned has to be more than EUR 25 million, and
- the aggregate Community-wide turnover of each of at least two of the undertakings concerned has to be more than EUR 100 million.

Again there is the same exception: If each of the undertakings concerned achieves more than two thirds of its aggregate Community-wide turnover within one and the same Member State, the concentration has no Community dimension.

Transactions fulfilling these criteria have to be interdicted by the Commission, if they lead to or strengthen a dominant market position of the new entity and therefore impede competition on the Common Market or a significant part of the Common Market.

The Merger Control Regulation 149/2004 also contains rules of how to calculate the thresholds, procedural rules and exceptions.

But the provision is silent about the nationality of the merging undertakings. This doesn’t cause a problem if these undertakings are incorporated in one of the European Union’s legal orders, as discrimination between “nationals” of different Member States is not allowed.

If undertakings from other countries (like the USA etc.) are involved the question arises, whether or not the Commission has jurisdiction. As in the *General Electric/Honeywell* case both parties are US-American this may cause a problem.

The definition of “Community dimension” actually refers to the impact and the participation in the Community market. As foreign entities acting inside the territory of the EU automatically have a Community-wide turnover, they fall within the provision. Deriving from the “effect doctrine” that seems to be commonly accepted by now, a merger control authority has jurisdiction over foreign subjects if their transaction effects the market where the authority is competent.

Therefore, applying the “effect doctrine” the European Commission is also competent to interdict a merger of two (or more) undertakings based outside the European Community.

Significant impediment of effective competition:

The significant impediment of effective competition can be measured by the detection of certain unilateral or coordinated effects.

A merger can significantly impede competition in the relevant market by eliminating pressure on one ore more competitors. Certainly the competition pressure is removed between the merging companies. But also third companies can benefit from the merger, because if the merged company increases prices, the other competitors can more easily accommodate demand at constant prices. If the competitors also increase prices competition pressure decreases.

Coordinated effects emerge mainly on very concentrated markets and consist in de facto coordination (without agreement) between the competitors (Commission, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings 2004/C 31/03).

For the evaluation of the consequences of a merger for competition the Commission compares the situation resulting from the merger with the situation that would exist without the merger taking place. For the identification of an impediment of effective competition in the relevant market three steps are to be taken:

- the definition of the relevant market,
- the examination whether and to which extent an intensification of the exercise of market power by the merged undertaking is likely,
- the examination of possible positive market effects to be countervailed against the increase of market power.

Relevant Market:

The definition of the relevant market (geographical and product market) is the same as explained above for Article 86 (now 82) in the *Continental Can* decision. The Commission Notice on the definition of relevant market for the purposes of Community competition law (97/C 372/03) provides for a set of criteria.

Relevant product markets are defined as follows:

A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and there intended use.

Relevant geographic markets are defined as follows:

The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring areas because the conditions of competition are appreciably different in those areas.

Market Power

In order to investigate the market power Article 2 paragraph one of the Merger Control Regulation 139/2004 enumerates a lot of factors that are to be taken into account:

- the structure of the relevant markets,
- actual and potential competition,
- economic power and financial position of the relevant companies,
- the alternatives available to suppliers and users,
- their access to suppliers or markets,
- legal or other barriers to entry,
- supply and demand trends for the relevant goods and services,
- the interests of the intermediate and ultimate consumers, and
- the development of technical and economic progress (provided that it is to consumers' advantage and does not form an obstacle to competition.

Reasons for justification:

Economies of scale

With an increasing quantity of produced goods the production cost falls.

Reasons for this decrease of costs resulting from a merger are for the field of production the combination special knowledge and the decrease of the fixed costs per item due to a greater quantity of produced goods. Also management costs can be cut down by the creation of profit centers or modern technology introduced by one of the merging units and subsequently utilized by the whole undertaking. In the field of advertising also costs can be saved (*Schmit, Ingo*, Wettbewerbspolitik und Kartellrecht[6], Eine Einführung, pp 85).

As a merger leads to bigger entities, the relevant goods can be produced at a lower price. But this lower price usually doesn't benefit the consumers because concentration eliminates competition and therefore prices for the consumers rise.

If the decrease of production costs benefits the consumers, this can be taken into account as a reason for justification.

Economies of scope

If different products are produced sold with shared resources this can also lead to a decrease of costs and to price advantages (*Schmidt, Ingo*, Wettbewerbspolitik und Kartellrecht[6], Eine Einführung, pp 97)

The Failing Firm Defense

If an undertaking is in danger of dropping out of the market and then is saved by a take over by another undertaking this can also have a positive effect on the market.

If the undertaking drops out of the market this can also lead to concentration of market power because the remaining competitors will seize the market shares of the perishing undertaking and strengthen their market power.

In order to prevent such a concentration a takeover can be justified. The Horizontal Merger Guidelines (2004/C 31/03) determines the conditions:

- The allegedly failing firm would in near future be forced out of the market because of financial difficulties.
- There is no less anti-competitive alternative.
- In the absence of a merger, the assets of the failing firm would inevitably exit the market.

4. Comment on the Application of EC Competition Law to the *General Electric/Honeywell* merger and Conclusion

As *General Electric* and *Honeywell* agreed to merge, the merger would certainly constitute a concentration in the sense of the Merger Control Regulation.

4.1 Jurisdiction of the Commission

Applying the "effect doctrine" the Commission has jurisdiction over the case. This doctrine has been applied also in the *Boeing/MacDonnell Douglas* decision (1997) and the *AOL/Time Warner* decision (2000), both concerning US-American mergers. These cases gave rise to a lively discussion, but merely on a theoretical basis, because in both cases both authorities – the US-Department of Justice and the European Commission – allowed the mergers.

In *General Electric/Honeywell* the situation is different. Although the US-American authority allowed the merger, the European Commission blocked it. The different application of in fact very similar competition rules led to opposite decisions. Of course, in many US-American essays the EC Commission decision was criticized.

Generally I believe that – although in international law the principle of territoriality is a very important one – every authority that is in charge to protect the market in its own territory should also be able to protect it from actions that are performed outside this territory but have a significant impact on its market. But I wouldn't go so far to say that the Commission has the competence to interdict a merger between two US companies that is controlled and allowed by the competent US authority. Of course, the *ne bis in idem* principle doesn't apply, because the impact on different markets (the US-market on the one hand and the EC-market on the other hand) are the two different central subjects. But I would still stick to the territoriality principle in respect to the interdiction.

As I stated above the EC Commission should be able to protect the European market. Therefore the EC Commission can declare a concentration incompatible with the common market, but in my opinion cannot interdict it or – if the merger has already taken place – order the parties to dissolve. There is no doubt that the Commission can impose fines because of actions performed inside the EC market distort competition on the European market. In the same sense actions performed outside the territory but having a strong negative impact on the European market can be treated by the Commission, but only in respect of this impact. Therefore in my opinion the Commission can only impose fines for distorting competition in the European market and apply Article 82 of the EC Treaty if the (merged) undertaking misuses its dominant position on the EC market.

4.2 Decision on the Merits

I have no objections to the findings of the Commission concerning the community dimension, the definition of the relevant markets, or the fact that the merger would lead to strengthen dominant market positions. But as analyzed above the different interests have to be balanced. Possible positive market effects have to be counterweighed against the increase of market power.

This comparison apparently led to opposite conclusions of the US Competition Authority and the EC Commission.

I believe that the effects of economies of scale and scope should be awarded more importance. The Commission admitted that especially in the fields of complementary products the quality and security of the different aircraft components could be better adapted to each other, and therefore the quality and security will increase.

Furthermore the Commission admitted that the prices of the goods produced by the merged company will decrease. In my opinion these effects can constitute a reason for justification.

The main reason for the Commission to block the merger was that the merged undertaking will increase its market power. But competition is all about the survival of the strongest. Therefore – as long as the increase of market power doesn’t lead to higher prices, lower quality and absence of innovation like in a monopoly situation – in my opinion the merger didn’t have to be blocked.

Besides that, to have market power doesn’t automatically mean to abuse market power. One of the arguments of the Commission was that the merged company could exercise uncompetitive measures such as bundling/tying. If this was the case, Article 82 EC Treaty provides for remedies against misuse of market power. Therefore, after the merger the new enterprise can’t enforce unjust buying or selling prices or other business terms, introduce exclusive supplying or acceptance duties, deny supply, apply different terms to similar performances vis-à-vis different business partners in order to cause disadvantages in competition for them, or set conditions linked to contracts pushing the other contracting party to accept duties that otherwise had no connection to the contract.

For the application of Article 82 of the EC Treaty I also have no concerns about the jurisdiction of the Commission, because only uncompetitive measures inside the EC market can be sanctioned and therefore there is no problem with the territoriality principle.

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