GE/HONEYWELL: CONTINUING THE TRANSATLANTIC DIALOG

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In July 2001, for the first time ever, the European Commission ("Commission") prohibited a merger of two U.S. firms the U.S. antitrust agencies had cleared. That decision,1 blocking the proposed merger of General Electric ("GE") with Honeywell International ("Honeywell"), triggered a vigorous debate between U.S. and European Union ("EU") competition officials not only over the decision, but also over merger policy toward conglomerate mergers generally.2

Immediately following the decision, Charles James, the newly appointed Assistant Attorney General for Antitrust, issued a press statement that criticized the Commission’s decision, saying it “reflect[ed] a significant point of divergence” between the two com-

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1 See Case COMP/M.2220, General Electric/Honeywell v. Commission (2001) [hereinafter GE/Honeywell] (detailing the provisions of the proposed merger), available at http://europa.eu.int/comm/competition/mergers/cases/index/by_nr_m_44.html#m_2220.

2 A “conglomerate merger” is generally defined by what it is not. The term is used to encompass all mergers that are neither horizontal (between direct competitors) nor vertical (between firms that have a buyer-seller relationship). As such, it is a broad term that encompasses mergers of complements and weak substitutes, as well as pure conglomerate mergers in which there is no relationship between the products of the merging firms.
petition authorities.3 This divergence prompted the U.S. Department of Justice Antitrust Division ("the Department") to take the unusual step of issuing a detailed explanation of its decision not to challenge the merger in a White Paper it submitted to the Organisation for Economic Cooperation and Development ("OECD") for a roundtable on conglomerate mergers in October 2001.4 That White Paper drew a detailed response from the Commission in a paper presented by the head of its Merger Task Force at the Fordham Corporate Law Institute later the same month.5 This, in turn, led the Department to further explain its views through a paper by this Author presented at a George Mason University School of Law symposium in November.6

This Symposium, sponsored by the University of Pennsylvania Journal of International Economic Law ("JIEL"), is the first program to take a detailed look at both the GE/Honeywell decision and the debate it generated. JIEL is to be commended for having organized this Symposium. The Justice Department welcomes critical scrutiny of its decisions by the academic community and the kind of dialog this Symposium is designed to promote. The Department particularly welcomes the opportunity to respond to some of the issues that have been raised, as to both the substance and the style of its response to the Commission's decision.

1. INTRODUCTION

Two competing views seem to have emerged with respect to the difference in outcomes in GE/Honeywell between the United States and Europe. The first, more optimistic view is that this was


6 See William J. Kolasky, Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels, 10 GEO. MASON L. REV (forthcoming Fall 2002) (comparing the fundamental difference in rationale for U.S. and EU challenges to mergers, specifically addressing the GE/Honeywell merger).
a one-time aberration, based on different factual findings. Those holding this view emphasize that this is the first time since the EU adopted its Merger Regulation in 1991 that one jurisdiction has blocked a merger involving global markets that the other would have allowed.\(^7\) This statistic may somewhat overstate the extent of convergence. However, a closer look would show that over this ten-year period, there have been relatively few merger decisions involving truly global markets. And while there is only one case where one authority prohibited a merger involving global markets over the objection of the other, there are at least two other mergers involving global markets—Boeing/McDonnell Douglas\(^8\) and Allied-Signal/Honeywell\(^9\)—in which the European Commission imposed conduct relief beyond what the U.S. agencies believed necessary.

The second, more pessimistic hypothesis, is that GE/Honeywell is only the tip of the iceberg. Under this view, the situation is a little like that of a homeowner who sees a termite and, when he pulls up the floorboard, finds that his beams have been nearly eaten away. Those holding this view fear that there are significant differences between the United States and the EU with respect to abuse of dominance and monopolization and that these differences may have contributed to the difference in outcomes in GE/Honeywell.\(^10\) For example, under EU law it is an almost per se abuse of dominance for a dominant firm to grant loyalty discounts unless they are cost justified.\(^11\) U.S. law, by contrast, allows and

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\(^7\) See John R. Wilkie, U.S. Antitrust Chief Criticizes EU Decision to Reject Merger of GE and Honeywell, WALL ST. J., July 5, 2001, at A4 (concluding “companies [were] sideswiped for the first time”).


\(^11\) See Eleanor M. Fox, U.S. and European Merger Policy—Fault Lines and Bridges, Mergers That Create Incentives for Exclusionary Practices, 10 GEO. MASON L.
indeed encourages companies to discount, so long as the resulting prices are not below cost and, even then, will intervene only if there is a dangerous probability that the discounts may serve to maintain or acquire monopoly power.  

Which of these two alternative pictures is right? The answer depends on one's perspective; this is an almost classic case of asking whether the glass is half empty or half full. One of Secretary of State Colin Powell's rules for effective leadership is that "[o]ptimism is a force multiplier." Applying that principle, there is certainly reason for optimism with respect to the convergence of U.S. and EU competition policy. Over the last ten years, under the leadership of Karel Van Miert and Mario Monti, the European Commission has made enormous progress in integrating modern economics into EU competition law and policy. This is most evident in Commissioner Monti's recent statements embracing the consumer welfare model of competition law and offering assurances that the Commission will not challenge a merger simply because it makes the merging firm a more efficient, and therefore stronger, competitor. Given this progress, to the extent there may still be differences in how the two jurisdictions apply their law, there is every reason to believe that over time these differences will be further reduced, even if they do not disappear altogether.

But for that to happen, the U.S. and EU competition authorities must continue to work together to promote convergence around sound competition principles. This requires that they engage each

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See Todd S. Purdum, Because It's Necessary, N.Y. TIMES, Apr. 12, 2002, at A1 (using one of Secretary of State Colin Powell's management precepts, known as Powell's Rules, to determine perspective on policy).
other in serious substantive discussions in order both to understand the reasons for the existing differences in approach, and to identify which approach better serves the interests of consumers, economic growth, and the global economy. Symposia like this one facilitate the kind of constructive dialog that is needed.

In that spirit, this Article begins with a brief discussion of the goals of antitrust and of the principles that should guide sound merger review. The Article then briefly reviews the reasons the Department did not challenge the GE/Honeywell merger on the basis of the theories on which the European Commission relied. Finally, the Article responds to some of the questions that have been raised about the Department’s approach by those who advocate or defend the Commission’s contrary conclusions. Because this is a Symposium, and because other papers have set the stage by describing the facts of the GE/Honeywell merger, this paper will not re-plow that ground.

2. THE GOALS OF ANTITRUST

In a speech in Cape Town, South Africa, I suggested six guiding principles for antitrust review of mergers. The six principles are:

(1) Protect competition, not competitors.
(2) Recognize the central role of efficiencies in antitrust analysis.
(3) Base decisions on sound economics and hard evidence.
(4) Realize that our predictive capabilities are limited.
(5) Impose no unnecessary bureaucratic roadblocks.

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15 The Department did find that the merger raised competitive concerns with respect to horizontal overlaps in the markets for the production of U.S. military helicopter engines and in the provision of heavy maintenance, repair and overhaul ("MRO") services for certain Honeywell aircraft engines and auxiliary power units ("APUs"). The Department reached a settlement with the parties pursuant to which they would have been required to divest Honeywell’s helicopter engine business and to authorize a new third-party MRO service provider for certain models of Honeywell aircraft engines and APUs. See Press Release, U.S. Department Of Justice Antitrust Division, Justice Department Requires Divestitures in Merger Between General Electric and Honeywell (May 2, 2001) (explaining the divestiture requirement conditioned by the Department for the approval of the merger), at http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm.

(6) Be flexible and forward-looking.

The divergent outcomes in GE/Honeywell implicate the first four of these principles.

2.1. Protect Competition, Not Competitors

While some may call this a slogan, it is the central axiom of modern American antitrust doctrine.\(^\text{17}\) It is also an axiom that has real meaning. As the Ninth Circuit explained in Rebel Oil v. Atlantic Richfield:

> Competition consists of rivalry among competitors. . . . Of course, conduct that eliminates rivals reduces competition. But reduction of competition does not invoke the Sherman Act until it harms consumer welfare. . . . Accordingly, an act is deemed anti-competitive under the Sherman Act only when it harms both allocative efficiency and raises the prices of goods above competitive levels or diminishes their quality.\(^\text{18}\)

What this principle means, in short, is that the antitrust laws should not seek to protect individual competitors, but should instead seek to protect the competitive process and thereby consumers.\(^\text{19}\)

2.2. Recognize the Central Role of Efficiencies

This principle is a corollary of the first. As former Treasury Secretary Lawrence Summers reminded the American Bar Association Section of Antitrust Law shortly after leaving office, "[T]he goal is efficiency, not competition. The ultimate goal is that there be efficiency."\(^\text{20}\) The point Secretary Summers was making is that

\(^{17}\) See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488-89 (1977) (holding that mergers should be condemned only when they have anti-competitive effects).

\(^{18}\) Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1433 (9th Cir. 1995) (discussing one of several common law principles that aid courts in distinguishing between exclusionary acts and competitive acts).

\(^{19}\) See United States v. Microsoft Corp., 253 F.3d 34, 58 (D.C. Cir. 2001) (noting that exclusionary practices harm the "competitive process" and thus consumers).

\(^{20}\) Lawrence H. Summers, Competition Policy in the New Economy, Address Before the ABA Section of Antitrust Law, in 69 ANTITRUST L.J. 353, 358 (2001).
the principal reason economists value competition is because it promotes both allocative and productive efficiency.21 Therefore, as the Department’s Director of Economics put it recently, “efficiency is the goal, competition is the process.”22 These first two principles are closely linked, because the more agencies try to protect competitors, the more they are likely to harm competition and therefore efficiency.

2.3. Base Decisions on Hard Evidence and Sound Economics

One of the leading U.S. antitrust cases that helped to move the U.S. antitrust law out of what Judge Douglas Ginsburg calls the dark ages and into the modern era was the BMI case in 1979, in which the Supreme Court wrote, “easy labels do not always supply ready answers.”23 Too much of the discussion of GE/Honeywell has fallen back on labels such as mixed bundling, technical tying, leveraging, vertical foreclosure, and “tool kits of dominance.” One of the things the United States has learned over the last quarter century is that labels should not be used to decide antitrust cases. Antitrust decisions should be based, instead, on a close examination of the hard facts, applying what Joseph Schumpeter called “the cold metal of economic theory” to the arguments made by both the parties and the complainants.24

2.4. Realize That Our Predictive Capabilities Are Limited

Merger analysis is necessarily forward-looking—it requires that a court or agency make the best prediction it can as to the likely effects of a yet-to-be-consummated merger. Because no one can foretell the future perfectly, enforcement decisions must balance the harm that may be caused by allowing a merger that turns out to be anti-competitive (what statisticians call “false negative,”

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22 See id. at n.4 (citing a quote by Kenneth Heyer in his address before the Merger Task Force of the European Commission’s Directorate General for Competition).


or type two error) against the harm that may be caused by blocking a merger that turns out to be efficiency-enhancing and thus pro-competitive (a "false positive," or type one error). In so doing, it is particularly important not to give up likely near-term benefits for more speculative long-term harms.

3. THE GE/HONEYWELL DECISION

Turning to the GE/Honeywell case, there were six key issues on which the United States and EU disagreed that were central to their divergent outcomes. These were: (1) Was GE dominant in large jet engines? (2) Would bundling be a successful exclusionary strategy? (3) Would GE’s financial strength give Honeywell a decisive advantage? (4) Could GE Capital Activation Series ("GECAS") be used to foreclose avionics rivals? (5) Were rivals likely to exit? And, finally, the ultimate question: (6) Would the harm outweigh the benefits?26

3.1. Was GE Dominant in Large Commercial Aircraft Engines?

The central premise of the complainants’ and of the European Commission’s decision was that GE was already dominant in the market for large commercial aircraft engines. The Commission found that the merger would both strengthen GE’s dominant position in that market and allow GE to extend its dominant position to the markets for avionics and non-avionics systems in which Honeywell competed.27 The Justice Department concluded to the contrary, that the market for large commercial aircraft engines was a bid market, characterized by large sophisticated buyers, in which GE faced substantial competition from two strong rivals and that GE could not, therefore, act independently of its competitors or customers, which is the prerequisite for a finding of dominance.28

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25 See C. Frederick Beckner, III & Steven C. Salop, Decision Theory and Antitrust Rules, 67 ANTITRUST L.J. 41 (1999) (arguing that a balance must be reached and information on market power be used to determine competitiveness).

26 The description in this section of the conclusions the Justice Department reached in reviewing the GE/Honeywell merger is based on the Department’s OECD White Paper, see OECD Roundtable, supra note 4. See also Kolasky, supra note 6.

27 GE/Honeywell, supra note 1, paras. 350-55.


https://scholarship.law.upenn.edu/jil/vol23/iss3/3
The Commission’s finding of dominance rested principally on its view that GE had a sixty-five percent share of the relevant market, as measured by outstanding orders for engines on large commercial aircraft currently in production. The Justice Department believed this method of measuring market share overstated GE’s market position. GE derived one-third of its share of outstanding orders from a single sole-source contract to supply engines for the Boeing 737 through CFM, its joint venture with Snecma. Excluding this one contract, the shares of the three rival engine manufacturers would be much more evenly balanced and would resemble the distribution of contract awards for the first several months of 2001, during which GE won forty-two percent of the orders, Pratt & Whitney thirty-two percent, and Rolls Royce twenty-seven percent.29 This led the Department to conclude that GE would not be in a position to exercise market power and therefore did not have a dominant position in this market.

Market shares aside, the performance of the market for large commercial aircraft engines further contradicted the claim that GE was already dominant. Customers described competition among the three rivals as fierce, a description that was confirmed by the deep and growing discounts that characterized recent engine sales. Just as in the classic example of razors and razor blades, large commercial aircraft engine manufacturers generally sold engines at a loss expecting to recoup that loss through the sale of spares and repairs. Far from losing ground to GE, GE’s rivals, Pratt & Whitney and Rolls Royce, both enjoyed growing revenues and profits and both were investing heavily in R&D. The results of recent engine competitions confirmed that Pratt & Whitney and Rolls Royce continued to be able to compete effectively and were not being dominated by GE. For example, the Pratt & Whitney/Rolls Royce joint venture, IAE, claims to have won seventy-two percent of orders on the advanced A320 family in 2001, in direct competition with the GE/Snecma joint venture, CFM.30

29 See Kolasky, supra note 6.
3.2. Was Bundling Likely to Be a Successful Exclusionary Strategy?

One of the main concerns GE’s rivals voiced during the merger review was that the merger would facilitate what they called “mixed bundling”—that is, selling a bundle of components, engine and avionics in this case, at a price lower than the total price of the components purchased separately.\textsuperscript{31} In a paper submitted for this Symposium, a Commission official claims that this concern did not feature prominently in the Commission’s decision to prohibit the GE/Honeywell merger, notwithstanding that the final decision devoted several pages to the issue.\textsuperscript{32} If true, this statement would raise a serious question as to what basis the Commission had for finding that the merger would strengthen GE’s dominant position in engines. The Commission’s other theories of competitive harm, based on GE’s so-called “toolkit of dominance,” could not have provided that basis because GE already enjoyed those advantages in the market for large commercial aircraft engines and there was never any suggestion that Honeywell would add any new tools, other than the ability to bundle.\textsuperscript{33}

It is not surprising, however, that the Commission’s spokespersons have tried to downplay the Commission’s reliance on mixed bundling. The Commission’s Statement of Objections relied on an economic model developed by an economics professor at Michigan State University, Jay Pil Choi, to support its original theory of mixed bundling. That model purported to show that the merger would produce a strong Cournot effect.\textsuperscript{34} Professor Choi based his model on prior work by Barry Nalebuff, a professor of economics at Yale. Testifying for the parties, Professor Nalebuff showed that

\textsuperscript{31} GE/Honeywell, supra note 1, paras. 350-55.


\textsuperscript{33} The Commission did find that Honeywell was the only non-vertically integrated manufacturer of starters for large commercial aircraft engines and that its acquisition by GE would give rise to vertical foreclosure concerns, but this vertical overlap was a distinct concern and would have been readily remediable through a relatively minor divestiture. GE/Honeywell supra note 1, paras. 302-29.

\textsuperscript{34} See Giotakos supra note 32, at 498-99 (explaining that a Cournot effect posits that a company that produces a number of complements will have an incentive to offer them at a lower price closer to marginal cost than would two firms producing those same complements individually because the firm will internalize the externalities (i.e., reduced demand) associated with high prices).
Choi's model did not fit a market, like aircraft engines and avionics, with differentiated products, powerful buyers, and large transactions that were individually negotiated. In the face of Professor Nalebuff's critique, the Commission eschewed any reliance on the Choi model in its final decision and has since said that it found the Cournot effects to have been quite small.

3.3. Would GE's Financial Strength Give Honeywell a Decisive Advantage?

Having largely disavowed the mixed bundling theory, spokespeople for the Commission maintain that the Commission's real concern was that GE would use what they termed its "toolkit of dominance" to drive both its and Honeywell's rivals from the market. This "toolkit of dominance" appears to have two elements, the first being GE's financial strength. The theory is that GE's financial strength would allow GE to take more risk in product development and offer customers discounts and other terms that its rivals would not be able to match, thus ultimately driving them from the market.

This argument is highly reminiscent of the "big is bad" arguments that had currency in the United States twenty-five or thirty years ago, but that have long since been discarded. The problem with the argument is that it makes no sense absent capital market imperfections, which were not shown in this case. And, if one assumes capital market imperfections, then applying GE's lower capital cost to a broader range of products would be efficiency-enhancing, in which case the theory seeks to protect competitors at the expense of consumers.

35 See Barry Nalebuff & Shihua Lu, A Bundle of Trouble-Bundling and the GE-Honeywell Merger (October 2001) (manuscript on file with authors) (demonstrating that bundling has no impact on consumption if prices are negotiated and there is perfect information).

36 See Giotakos, supra note 32, at 500 (showing that the Cournot effects were not large enough to overcome the detriment to consumer welfare).

37 See Giotakos, supra note 32, at 484 (suggesting that the merger would eliminate or marginalize rivals in complementary markets, leading to an eventual increase in prices and difficulties for competitors re-entering the market).
3.4. Would GECAS's "Buy GE Only" Policy Lead to Vertical Foreclosure?

The second, and perhaps more important, weapon in GE's alleged "toolkit of dominance" was its aircraft leasing operation, GECAS. The concern was that extending GECAS's "Buy GE Only" procurement systems policy for engines to Honeywell avionics and non-avionics systems would cause airframe manufacturers to select those systems, thereby ultimately foreclosing Honeywell's rivals from the market. This theory is analogous to the old reciprocal dealing theory found in cases, such as Consolidated Foods, in the United States during the 1960s.

In its OECD White Paper, the Justice Department identified three key problems with this theory of competitive harm. First, GECAS accounted for less than ten percent of total aircraft purchases, a percentage that falls well below the minimum threshold for vertical foreclosure concerns recognized in the case law. Second, the argument failed to take account of the counter-strategies available to GE's engine and leasing rivals, which the Department concluded would likely fully counteract any procurement bias on GECAS's part. It did not, therefore, represent a Nash equilibrium. Third, the theory was counterfactual. GECAS has been making speculative purchases of aircraft in significant quantities

38 GE/Honeywell, supra note 1, paras. 350-55.
39 See FTC v. Consol. Foods Corp., 380 U.S. 592 (1965) (holding that reciprocal buying, which protected the market of the acquired company, along with Consolidated Food Corporation's reciprocal buying power, obtained through the acquisition, created an anti-competitive obstacle in violation of Section 7 of the Clayton Act).
40 OECD Roundtable, supra note 4, at 22-23.
41 Generally, vertical foreclosure concerns arise only when the buyers involved represent 30-40 percent of the market for the good or services in question. See, e.g., United States v. Microsoft Corp., 1998-2 Trade Cas. ¶ 72,261, at 82,680 (D.D.C. Sept. 14, 1998) (granting summary judgment against the government's exclusive dealing claim).
42 For those unfamiliar with it, the Nash Equilibrium is well explained in the bar scene in the movie A Beautiful Mind where John Nash is shown conceiving the Nash Equilibrium, for which he later won the Nobel Prize. Instead of Nash and his two friends all rushing to the most beautiful girl, their optimal strategy was to rush the three less attractive girls and leave the beautiful girl alone. The point is simply that a strategy can represent an equilibrium only if it assumes the other players will each play their optimal strategy. See A BEAUTIFUL MIND (Universal Pictures 2001).
since 1996, and yet GE’s share of recent engine contract awards by leasing companies has fallen, not increased, since then.43

Two economists who submitted economic analyses of the GE/Honeywell merger on behalf of complainants in both the U.S. and EU merger review proceedings, Robert Reynolds and Janusz Ordover, have now published an article attempting to respond to these criticisms.44 Their article, however, underscores the weaknesses in their highly theoretical argument, and the total lack of any factual basis for their claim that GECAS could tip the market for avionics and non-avionics systems decisively in Honeywell’s favor.

The central premise of the Reynolds/Ordover argument is that because airframers’ aircraft prices exceed their incremental costs, even a small shift in aircraft sales resulting from a change in GECAS’s purchasing behavior would produce an effect on airframers’ margins larger than any price reduction Honeywell’s rivals could afford given the need to sustain the R&D investment to remain in the market.45 Reynolds and Ordover discount the likelihood that Honeywell’s rivals would have counteracted this effect by merging or teaming with rival leasing companies on the ground that GE’s engine rivals had not done so to date.

This Article is not the place to respond in detail to the Reynolds/Ordover defense of their theory, but a few observations are in order. The first is that the theory rests critically on two strong assumptions: first, that airframe manufacturers are indifferent as between the avionics and non-avionics systems embedded in their aircraft and, second, that aircraft customers are also indifferent between aircraft. Otherwise, GECAS would lose market share if it selected an inferior aircraft just because it contained Honeywell systems, making a threat to do so non-credible. These are similar to the assumptions on which the Choi model of mixed bundling was based. As Professor Nalebuff showed, and as the Commission essentially conceded by discarding the Choi model, those assumptions do not fit the aircraft industry, where highly sophisticated buyers make buying decisions based on very detailed technical

43 See Robert J. Reynolds & Janusz A. Ordover, Archimedian Leveraging and the GE/Honeywell Transaction, 70 Antitrust L.J. 171, 185 (2002) (arguing that the GE/Honeywell merger would have harmed competition and consumers).

44 See id. (responding to critics of the EC’s decision).

45 See id. at 174-76 (outlining the control premise of the Reynolds/Ordover argument).
evaluations of the relative cost and performance of competing systems and aircraft. Yet without these assumptions, the Reynolds/Ordover claim that GECAS's GE-only procurement policy with respect to engines, which are purchased separately from the aircraft, could be extended to systems that are embedded in the aircraft falls apart.

The second is that the empirical evidence contradicts the theory. GECAS's GE-only procurement policy has not, in fact, shifted market shares for engines in GE's direction. To the contrary, GE's share of engine contract awards by leasing companies fell from sixty percent for the 1991-1997 period to fifty-one percent for the more recent 1998-2001 period. Examining the data more closely shows that the reason is, just as one would expect, that rival leasing companies have reduced their purchases of GE engines substantially in response to GECAS's pro-GE bias. In the 1998-2001 period, GE engines accounted for twenty-eight percent of rival leasing company purchases, as compared to fifty-three percent in the earlier period.

In short, the Reynolds/Ordover theory that GECAS will somehow be able to use its sub-ten-percent share of engine purchases as an "Archimedean lever" to make Honeywell the dominant sup-

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46 See generally Nalebuff & Lu, supra note 35 (disputing the applicability of the Choi model to the aircraft industry). See also GE/Honeywell, supra note 1, at 56 (discussing the exercise of buyer power in the airline industry).

47 Once we relax these assumptions, it is simply not credible that GECAS would boycott a popular airframe just because one, several, or even most of the avionics or non-avionics systems were supplied by Honeywell's rivals. For example, GECAS could not afford to boycott a popular narrow-body airframe, such as the B737 or A320, which are the bread and butter of leasing companies and the bulk of what GECAS purchases, simply because it contains a rival's avionics or non-avionics systems. (GECAS's GE-only engine procurement policy, by contrast, does not prevent GECAS from purchasing these aircraft because engines are buyer-furnished equipment.) The airframe manufacturers are sophisticated and would know that any threatened GECAS "boycott" was simply not credible.

48 GE/Honeywell, supra note 1, paras. 71-73.

49 See id. at 24. This, of course, is a complete answer to the Ordover/Reynolds response to the Department's conclusion that rivals would be able to counteract GECAS's GE-only buying policy by merging with, or entering into teaming arrangements with, rival leasing companies. Ordover and Reynolds argue that since GE's engine rivals have not yet done so it is unlikely Honeywell's rivals would do so. Since the data show the GECAS's bias has not served to increase GE's market share for engines, and may even have helped reduce it by causing rival leasing companies on their own initiative to shift purchases away from GE, it is easy to understand why GE's engine rivals have not found it necessary to merge or team with rival leasing companies.
plier of avionics and non-avionics systems cannot withstand scrutiny. It is fortunate that by publishing their theory, they have exposed its all-too-obvious flaws.

3.5. Would Rivals Have Been Likely to Exit?

Both the mixed bundling and “toolkit of dominance” theories of competitive harm posit that consumers would be better off in the short-term, because GE would offer them lower prices than its rivals, but would suffer in the long-term because GE’s rivals would ultimately be driven from the market, after which GE would be able to raise prices to a supra-competitive level. They depend importantly, therefore, on a finding that GE and Honeywell’s rivals would not be able to match the attractive terms offered by the merged firm and would ultimately exit the market.

The Justice Department, unlike the Commission, found these predictions of ultimate demise difficult to credit. First, both GE’s engine rivals and Honeywell’s systems rivals are large, financially healthy companies with a deep commitment to the aerospace industry. Second, these markets are characterized by powerful buyers, such as Boeing, Airbus, and the major airlines, all of whom have a strong incentive to maintain a competitive supply base. Third, GE and Honeywell’s rivals appeared to have effective counter-strategies available; for example, the industry has a history of successful teaming arrangements. Indeed, a large part of GE’s market share was due to its CFM joint venture with Snecma. Pratt & Whitney and Rolls Royce similarly have joint ventured to develop a new engine that is winning an increasing share of Airbus contracts. On the avionics side, the Commission found, in reviewing the AlliedSignal/Honeywell merger just two years earlier, that teaming arrangements were an effective competitive strategy in these very markets.

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50 See Reynolds & Ordover, supra note 43, at 174 (defending the Commission’s decision, Reynolds and Ordover introduce for the first time the argument that the merger might have enabled Honeywell to charge higher prices for its systems even prior to its rivals exiting the market). This assertion, which even the Commission appears not to have accepted, is based on their flawed theory of “Archimedean leveraging.” It also fails to take into account the countervailing Cournot effect, which would give Honeywell an incentive to decrease, not increase, prices.

51 See AlliedSignal/Honeywell, supra note 9, para. 118 (noting that commercial teaming has been successful).
3.6. Would the Harm Outweigh the Benefit?

![Figure A]

Whether $M > C$ is function of:
- Size of price cuts
- Duration of competitive round
- Ability to shift purchases
- Level of monopoly price
- Duration of monopoly
- Probability of rival exit
- Discount rate
- Probability of rival exit
- Level of monopoly price

The ultimate question under the complainants’ theory of “benefit now, harm later” is whether the harm would outweigh the benefit. The complainants’ theory was that, as a result of the merger, GE/Honeywell would be able to offer better products at lower prices to its customers, but that consumers would ultimately suffer because those better prices would drive rivals from the market, after which the merged firm would gain a monopoly and could raise prices above pre-merger levels.\(^\text{52}\) Figure A is a simplified graph showing both the hypothetical benefits and harms.

As Figure A illustrates, consumers are worse off only if $M$ (the amount of the overcharges post-exit) is greater than $C$ (the amount of the savings during the competitive, pre-exit period). That, in turn, is a function of a large number of variables. These include: (1) the size of the post-merger/pre-exit price cuts, (2) the probability that those benefits will be realized, (3) the duration of the price cuts—how long it would take to drive the rivals from the market, (4) the probability that rivals will in fact exit, (5) the ability of customers to shift purchases into the competitive period anticipating higher prices after the rival has exited, (6) the level of the monopoly price, (7) the duration of the feared monopoly (which depends on how long it would take for new entry to occur), and (8) because the harm occurs later than the benefits—the discount rate. In calculating these variables, it is particularly important to remember that monopoly prices are not always above competitive prices. If

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\(^{52}\) See GE/Honeywell, supra note 1, para. 86 (discussing GE’s market dominance and monopoly potential).
the monopolist is more efficient than a small group of oligopolists, the monopoly price can be lower than the oligopoly price.\footnote{This would be particularly true if the oligopolists are playing Cournot, which is a necessary assumption in order for mixed bundling to have a substantial impact.}

Given the large number of variables, it is easy to see how difficult it is to predict with confidence that the harm would outweigh the benefits. For that reason, an agency or court should be very cautious before it accepts this kind of a story of "short-term benefit, long-term harm." The short-term benefits are always more certain than the long-term harms. If the benefits (in the form of efficiencies, lower prices, etc.) are not realized, there may be no benefit, but there is also no harm. If the efficiencies are realized, the rivals may find ways to respond. (Returning to A Beautiful Mind, the boys will approach the less attractive girls.) Even if the rivals do not respond, the customers may behave strategically so as to preserve competition. (In other words, the less attractive girls may come over and start talking to the boys.) Even if rivals eventually exit, the prices charged by the efficient monopolist may be lower than the prices charged by a small number of less-efficient oligopolists. For these reasons, estimating the probability of exit and quantifying the benefits of harms discounted to present value will generally exceed our ability to forecast the future. We need, therefore, to quote a character from another movie, Tin Cup, to "be humble."\footnote{TIN CUP (Warner Bros., 1996).}

4. Responding to Critics

The other papers presented at this Symposium raise a number of issues that merit a brief response.

4.1. Sloganeering?

In some of the papers submitted for this Symposium and elsewhere, the Justice Department has been accused of engaging in sloganeering in its criticisms of the Commission's decision in GE/Honeywell, and especially for the suggestion that it reflected an approach designed more to protect competitors than competition.\footnote{See Edward T. Swaine, "Competition, Not Competitors," nor Canards: Ways of Criticizing the Commission, 23 U. PA. J. INT'L ECON. L. 597 (2002) (analyzing the critiques of the Commission's decision).} These criticisms get it exactly backwards. The reason the Antitrust

Division took the unusual step of laying out the reasons for its decision not to challenge the GE/Honeywell merger was to assure that this dispute would not be reduced to mere sloganeering. What the Department sought instead was a serious substantive dialog over the differences in approach between the two jurisdictions. To stimulate such a dialog, the Department recognized that it would need to take the unusual step of laying out publicly the reasons for its decision not to challenge a merger that the European Commission had decided to prohibit. This Symposium, and the other articles that have appeared debating the merits of the two agencies' differing approaches to the case, provide an opportunity for just the kind of dialog the Department had hoped for.

4.2. A False Efficiencies Debate?

Another paper submitted for this Symposium takes issue with the claim that the European Commission's decision to prohibit the GE/Honeywell merger was premised on the efficiencies the merger would have generated.56 It maintains that the parties did not claim any substantial merger-specific cost savings and argues that the price cuts the Commission feared were therefore not due to any efficiencies but were simply "strategic" in nature.57

This argument takes too narrow a view of efficiency. Its premise seems to be that the only efficiencies that matter are cost-savings that serve to reduce the marginal cost of production. But given that the principal economic argument against monopoly is that it harms allocative efficiency, it is hard to see how a rational merger policy could disregard positive effects on allocative efficiency flowing from a merger. Any price cut that moves prices closer to marginal cost, however motivated, promotes allocative efficiency. That is, in fact, one of the principal ways in which vertical integration, whether by merger or internal growth, enhances efficiency—namely, by eliminating what economists call "double-marginalization."58 The Cournot effect flowing from a merger of complements is similarly efficiency enhancing—it reduces prices and increases output by causing the firm to internalize the externalities imposed by high prices and restrictions of output. Label-

56 Giotakos, supra note 32, at 469.
57 Id. at 476.
58 See Kolasky & Dick, supra note 21.
ing these price reductions "strategic" adds nothing to the discussion.\textsuperscript{59}

Even leaving these non-cost-saving efficiencies aside, it is hard to square the argument that the parties did not claim any cost savings with GE's public statements concerning the merger. In his book, Straight from the Gut, GE's former CEO, Jack Welch, claimed that GE expected to realize $1.5 billion in cost savings, principally through the application of best practices, including GE's vaunted management techniques, to Honeywell's activities.\textsuperscript{60} Combining complementary assets—and good management systems are a very important complementary asset—is a well recognized source of merger-specific efficiencies.\textsuperscript{61} To the extent GE may not have emphasized these efficiencies in its dealings with the Commission, that is hardly surprising given that the theories the Commission was pursuing seemed to treat efficiencies more as a reason for prohibiting the merger than for approving it.

\textbf{4.3. Ex Ante Versus Ex Post Relief}

An argument that is sometimes advanced by those seeking to defend, or at least explain, the Commission's decision is that it is harder in Europe than in the United States to obtain ex post relief against tying and other anti-competitive acts and that it is, therefore, more important to intervene ex ante.\textsuperscript{62} A related argument, somewhat akin to the evasion of rate regulation theory for challenging vertical mergers,\textsuperscript{63} is that the Chicago School critique of tying—namely that a monopolist cannot increase its monopoly

\textsuperscript{59} Another important part of the Commission's case was premised on the competitive advantages GE would derive from extending GE's access to cheap capital to Honeywell's operations, especially in terms of product development and being able to offer more favorable terms on initial equipment purchases. This, again, was an efficiency that would have directly benefited customers.

\textsuperscript{60} Jack Welch & John A. Byrne, Jack: Straight from the Gut 362 (Warner Books 2001).

\textsuperscript{61} See Joseph Farrell & Carl Shapiro, Scale Economies and Synergies in Horizontal Merger Analysis, 68 Antitrust L.J. 685 (2001) (evaluating some aspects of the treatment of efficiencies, including litigated mergers).

\textsuperscript{62} Giotakos, supra note 32, at 503-04. Even if the premise of this argument were true, it would leave open the question of why the Commission could not have relied on the admitted deterrent effect of U.S. law, given that the markets involved were global.

profit by acquiring a second monopoly over a related good used in fixed proportions because there is only one monopoly profit to be earned—has less resonance in Europe because firms in Europe cannot fully exploit their monopoly power without violating the prohibition on abuse of dominance.\textsuperscript{64} Both arguments miss the mark.

The first argument suffers from at least three problems. First, the type of mixed bundling feared in GE/Honeywell—that is, offering a lower price on a bundle of goods than on the goods individually—would not have constituted an unlawful tie, at least under U.S. law, even if it had occurred, so long as the prices for the individual components were not "exorbitant" and the prices for the bundle were above cost (and there was no claim in GE/Honeywell that they would not be).\textsuperscript{65} Second, while a naked contractual tie is per se unlawful, other types of ties, especially so-called technological tying, are generally evaluated under the rule of reason.\textsuperscript{66} The question then is how an agency is to determine ex ante that the leveraging practices the merged firm might engage in would be welfare enhancing or welfare harming. It is hard enough to determine that after the fact when the tie actually occurs; it would be nearly impossible to do so when the agency has to guess at the form the tie will take and at what the structure of the market will be at that point in time. Third, the law on tying and other forms of leverage is at least as, if not more, restrictive in Europe than in the United States.\textsuperscript{67} It is difficult to understand why the risk of substantial fines in Europe would have any less deterrent effect than the risk of treble damage liability in the United States.

The second argument likewise suffers from at least one fundamental flaw. While it is true that exploitative pricing is technically an abuse of dominance under Article 82, in Europe, exploitative

\textsuperscript{64} Giotakos, supra note 32, at 501.

\textsuperscript{65} See ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 191-93 (5th ed. 2002) (noting that, while courts have allowed packaged discounts, they have also found them coercive when ordering the goods individually would have resulted in exorbitant pricing and providing examples of uncoercive pricing).

\textsuperscript{66} See U.S. v. Microsoft Corp., 253 F.3d 34, 84-97 (D.C. Cir. 2001) (holding that the "rule of reason," rather than per se analysis, should govern the legality of tying arrangements involving platform software agreements).

\textsuperscript{67} See THE EC LAW OF COMPETITION 241 (Jonathan Faull \& Ali Nikpay eds., Oxford University Press 1999) (stating that the test for when a concentration is not compatible with the common market is "the creation or strengthening of a dominant position as a result of which effective competition would be impeded in the common market or a substantial part of it").
pricing cases are very rare. The European Commission and national competition authorities recognize, as do the U.S. courts, that it would be very difficult to prove that pricing is exploitative without becoming a price regulator, something competition authorities are ill-equipped to become. The European competition authorities also recognize, as the U.S. courts and agencies do, that monopoly prices send an important price signal to the market that invites entry and expansion by rivals. This being the case, it is hard to credit an argument that monopolists are more likely to seek a second monopoly in Europe than they are in the United States and that stronger ex ante preventive measures are therefore necessary.

4.4. Did Differences in Substantive Standards Account for the Different Outcomes?

Some have tried to attribute the different outcomes in GE/Honeywell to differences in the substantive standard for merger review in the two jurisdictions. In Europe, the standard is whether a merger will create or strengthen a dominant position, whereas, in the United States, the standard is whether the merger may substantially lessen competition. In practice, however, there is little, if any, difference between these two standards. The U.S. Horizontal Merger Guidelines define a substantial lessening of competition as creating or facilitating the exercise of market power. In Europe, a dominant position is defined in terms of being able to act independently of the firm’s competitors and customers. That definition of dominance is essentially synonymous with the definition of market power in the United States. The U.S. “substantial lessening of competition” test, therefore, could be said to incorporate a dominance test. Conversely, the EU Merger Regulation requires a finding not only that a merger will create or strengthen a dominant position, but also that “as a result . . . effective competition would be significantly impeded in the common

68 See id. at 190-92 (noting the difficulty in prosecuting excessive pricing).
71 Kolasky, supra note 6.
part or a substantial part of it.\textsuperscript{72} The EU dominance test, therefore, can be said to incorporate a substantial lessening of competition test. Since both tests are concerned with preventing the creation or increase of market power as a result of which competition will be substantially lessened, it is hard to see why the different verbal formulations should lead to different outcomes.

4.5. Are the U.S. Agencies Too Skeptical of Competitor Complaints?

Some have suggested that the U.S. antitrust agencies are overly skeptical of competitor complainants. It is true that the U.S. agencies are deeply skeptical when rivals complain; they believe, as William Baxter used to teach, that the more competitors complain, the more likely it is that a merger will be good for consumers. But the U.S. agencies do not disregard information supplied by competitors, any more than they do information from any other source. The agencies look at the facts closely and will bring cases based on rival complaints where there is a sound theory of competitive harm supported by the facts. Last summer, for example, during the same month that the Commission prohibited the GE/Honeywell merger, the Justice Department secured a consent decree partially blocking a vertical merger of the largest residential door manufacturer with the largest supplier of molded doorskins (a key input) based largely on complaints received from downstream competitors.\textsuperscript{73}

4.6. Does the U.S. Take Too Short-Term a View?

Another overly simplistic explanation sometimes offered for the conflicting decisions is that the Commission is more concerned about the long-term effects of mergers than the U.S. agencies are, the implication being that the U.S. agencies are typical "short-sighted Americans.\textsuperscript{74} While it is certainly true that the U.S. agencies are appropriately modest about their ability to predict the future generally, and especially the more distant future, it is not true that the U.S. agencies are not concerned about long-term effects. One of the reasons, for example, that the Horizontal Merger Guidelines set the timeframe for entry at two years is that the

\textsuperscript{72} Control of Concentrations, \textit{supra} note 69, art. 2(3).


\textsuperscript{74} Giotakos, \textit{supra} note 32, at 499.
agencies recognize that it would make no sense to expend administrative resources challenging mergers the negative effects of which will be only short-term. Similarly, in pharmaceutical mergers, where the product development pipelines are very long, the agencies will challenge mergers even though the anti-competitive effects will not be felt for several years. The difference, therefore, is not long-term versus short-term. The difference, rather, is in the comparative willingness to trade off likely short-term benefits against more speculative long-term harms. There, the U.S. agencies believe caution is appropriate.

4.7. Does Having to Go to Court Make the U.S. Agencies Too Cautious?

Another suggestion that is sometimes made is that having to go to court chills the willingness of the U.S. agencies to bring cases even where they think anticompetitive harm is likely because of fear of losing. While it is certainly true that having to go to court imposes a useful discipline, it is not true that the U.S. agencies are unwilling to risk losing. Just last fall, the Justice Department challenged a merger of two companies supplying shared disaster recovery computer services, which it lost in District Court because the court found the Department’s alleged market definition too narrow. The Department will bring cases whenever it is convinced a merger is likely to result in a substantial lessening of competition.

4.8. Were the Different Outcomes a Result of No One Being at Home in the United States?

The GE/Honeywell merger was reviewed during a period of transition in the United States from the Clinton to the Bush Administration. Some have suggested that this contributed to the divergent outcomes because there were no senior officials in place in the United States to whom the Commission leaders could talk. This is simply untrue. One of the first things the newly appointed Deputy Assistant Attorney General for Civil Litigation did after arriving in office was to fly to Brussels to meet with senior Commission officials, and once the new Assistant Attorney General was in

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office, he had several telephone consultations with his counterparts in Europe. Both sides knew they were reaching divergent outcomes and discussed the merits of the issues. That said, it is certainly desirable in future cases that there be more direct contact between senior officials at both agencies at earlier stages of investigations than generally has been the case in the past. The U.S. antitrust agencies and the Commission are currently working to develop better practices for coordinating their merger reviews that will provide for more frequent direct contact from the very outset of an investigation.

4.9. Is the U.S. Approach Too Darwinian?

The final criticism that is sometimes voiced is that the U.S. approach is too Darwinian, the argument being that we need to be protective of competitors because without competitors, there can be no competition. The U.S. view is that it is very risky for antitrust agencies and courts to try to manage the competitive process. As Franklin Roosevelt’s Assistant Attorney General for Antitrust, Thurman Arnold, put it seventy-five years ago: “The economic philosophy behind the antitrust laws is a tough philosophy. [Those] laws recognize that competition means someone may have to go bankrupt. They do not contemplate a game in which everyone who plays can win.” Indeed, it is the fear of failure, as much as the hope of success, that stimulates firms to innovate and become more efficient.

5. Conclusion

This article has already made references to several movies but one more is in order. In Jerry Maguire, the character played by Cuba Gooding, Jr. repeatedly says, “Show me the money.” This is an appropriate challenge to issue to those who would have competition agencies challenge conglomerate mergers on the basis of the types of theories advanced in GE/Honeywell. They should be asked to identify even one merger that benefited consumers in the short-term with better products and lower prices but that led to the

76 Giotakos, supra note 32.
77 Quoted by Jack Brooks, Remarks at Symposium: In Commemoration of the 60th Anniversary of the Establishment of the Antitrust Division (Jan. 10, 1994) (quoting 39 ANTITRUST BULL. 839 (1994)).
78 JERRY MAGUIRE (TriStar Pictures 1996).
exit of rivals and then left the economy worse off. There may be such mergers, but to date no one has identified one.