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On December 14, 2005,[1] the European Court of First Instance (CFI) upheld the European Commission's 2001 prohibition of a proposed merger between General Electric (GE) and Honeywell (the "Decision").[2] The Decision's partial reliance on conglomerate effects theories had been controversial at the time, and the Commission was criticised in strong terms by U.S. regulators that had approved the transaction. Following a recent series of judicial reversals of EC merger prohibition decisions,[3] the CFI's confirmation of the Decision must have come as a relief to the Commission. However, the grounds on which the Decision was upheld were narrow and, in respect of the most controversial aspects of the Decision—namely its reliance on alleged vertical and conglomerate effects—the CFI found that the Commission had committed manifest errors. Together with recent judgments of the CFI and European Court of Justice (ECJ) in *Tetra Laval*, the CFI's judgment in *GE/Honeywell* confirms the high standard that the Commission must meet to prohibit a conglomerate merger, thereby making it less likely that such transactions will be prohibited in the future.

1 Case T-210/01, General Electric v. Commission, 2001 O.J. (C 331) and Case T-209/01, Honeywell v. Commission, 2001 O.J. (C 331).

2 Commission Decision 2004/134/EC, General Electric/Honeywell, 2004 O.J. (L 48) 1 [hereinafter *GE/Honeywell*].

3 Case T-342/99, Airtours plc v. Commission, 2002 E.C.R. II-3585; Case T-310/01, Schneider Electric v. Commission, 2002 E.C.R. II-4071; and Case T-5/02, Tetra Laval v. Commission, 2002 E.C.R. II-4381 [hereinafter *Tetra Laval*].

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I. The Decision

On July 3, 2001, following an in-depth investigation, the Commission prohibited GE's proposed merger with Honeywell. The Commission identified the following four main competition concerns.

1. First, the Commission determined that GE held a pre-existing dominant position in large regional jet engines, which would be strengthened by the addition of Honeywell's competing business on this market (i.e., horizontal effects).

2. Second, the Commission found that the combination of GE's and Honeywell's activities in the markets for corporate jet engines and small marine gas turbines would create dominant positions (i.e., horizontal effects).

3. Third, the Commission found that Honeywell had a strong position in engine starters (which are a necessary input for creating a full engine package). The Commission considered that GE's acquisition of Honeywell's engine-starter business would strengthen GE's pre-existing dominance in large commercial jet engines because it would allow GE to disrupt supplies of Honeywell engine starters to GE's engine competitors (i.e., vertical effects).

4. Fourth, and most controversially, the Commission concluded that the combination of GE's dominant position in large commercial jet engines and Honeywell's leading positions in a broad range of avionics and non-avionics systems would create a dominant position in the avionics markets through two types of conglomerate effects:

    - The first effect would arise from GE's reliance on its leasing subsidiary GE Commercial Aviation Service (GECAS), which buys aircraft from manufacturers and leases them to airlines. The Commission held that GE could use GECAS as a commercial lever by offering airframe manufacturers and airlines concessions in return for specifying Honeywell products on the aircraft they purchase. The Commission found that GE had used GECAS in a similar way to promote its large commercial jet engines.

    - The second effect would arise from GE's bundling of its large commercial jet engines with Honeywell's avionics products. According to the Commission, such bundling could take the form of pure bundling (i.e., refusing to make available the engines without the avionics), technical bundling (i.e., integrating the engines and the avionic systems) or mixed bundling (i.e., offering a discount if customers take both the engines and the avionics from GE). As a result, GE could extend its dominance from large commercial jet engines to avionics. Conversely, GE's bundling of avionics systems in which Honeywell held a leading position would also reinforce its pre-existing dominance in large commercial jet engines.

II. The Judgment

The CFI subjected each of the Commission's findings to close examination. It referred to the judgment of the ECJ in *Tetra Laval*, which had recognized that while the Commission enjoys a margin of discretion in "appraisals of an economic nature," the CFI was obliged to review whether the Commission's "evidence [. . .] is factually accurate, reliable, and consistent, [ ] whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it."

The CFI held that the Commission's findings on the strengthening of a dominant position in large commercial jet engines and the creation of a dominant position in avionics were not sufficiently supported. At the same time, however, it confirmed the Commission's findings on the strengthening of a dominant position in large regional jet engines and the creation of dominance in corporate jet engines and small marine gas turbines. The CFI concluded that the findings on large regional jet engines, corporate jet engines, and small marine gas turbines were each sufficient to support a prohibition of the proposed merger, and that the Commission's errors as regards large commercial jet engines and avionics, therefore, did not justify annulment of the Decision.

A. STRENGTHENING OF GE'S DOMINANT POSITION IN LARGE REGIONAL JET ENGINES THROUGH HORIZONTAL OVERLAPS

The CFI confirmed that the Commission had properly established GE's existing dominance on the basis of market share data. GE's engines accounted for 60-70 percent of large regional aircraft still in production and for 90-100 percent of order backlogs for large regional aircraft not yet in service. Third-party suppliers, other than Honeywell, were not active on the market at the time of the Decision.

The CFI confirmed the Decision's finding that GE's dominant position in large regional jet engines would have been strengthened notwithstanding the absence of direct competition between GE's and Honeywell's engines. At the level of airlines, there was no direct competition since airframe manufacturers only certified one engine for a given airframe, while, at the level of airframe manufacturers, there was no direct competition because GE's engines could only be used on a two-engine platform while Honeywell's engines could be used only on a four-engine platform.

The CFI upheld the Commission's determination that GE's and Honeywell's engines competed indirectly through the selection by airlines of complete aircraft equipped with different engines. Among other things, the CFI pointed to internal GE documents demonstrating that GE granted discounts on its engines in order to boost the sale of aircraft equipped with its engines. Accordingly, so the CFI reasoned, the merger would have eliminated existing competition between GE and Honeywell engines.

Given that the merger would have effectively given GE a monopoly in engines for large regional aircraft, the CFI rejected GE's contention that the acquisition of Honeywell would have had only a marginal impact on its position. The CFI noted that, under Article 82 of the EC Treaty, the greater the dominance of an undertaking, the greater its obligation to abstain from any conduct that is liable to weaken existing competition. By analogy, the CFI held, a company with a strong dominant position cannot contend that the acquisition of a competitor does not raise concern simply because that rival is already weak or merely exercises an indirect competitive constraint. Rather, the reduction of any residual competition is particularly harmful.

By analogy, the CFI held, a company with a strong dominant position cannot contend that the acquisition of a competitor does not raise concern simply because that rival is already weak or merely exercises an indirect competitive constraint.

Finally, the CFI found no fault with the Commission's rejection of commitments offered by GE in an effort to address this concern, since there were legitimate doubts as to whether the divestiture of Honeywell's large regional engine business would have created a viable business.

B. CREATION OF A DOMINANT POSITION IN CORPORATE JET ENGINES AND SMALL MARINE GAS TURBINES THROUGH HORIZONTAL OVERLAPS

The CFI confirmed the Commission's findings on the creation of a dominant position in engines for corporate jets and small marine gas turbines.

Corporate jet engines

The CFI agreed that the Commission could rely on the parties' market shares for its conclusion that the transaction would create a dominant position in corporate jet engines. The merged entity would have held 50-60 percent of the installed base of engines for corporate jets and 80-90 percent of engines for medium corporate jets. The CFI noted that, in line with past case law, such shares were in themselves sufficient to demonstrate dominance.[4]

Small marine gas turbines

The dispute on this point focused on the Commission's identification of a relevant market limited to gas turbines of 0-10 megawatts for marine applications. GE maintained that GE's and Honeywell's gas turbines did not compete with each other. The Commission's definition was based largely on responses to information requests received from three competing suppliers of small gas turbines. The CFI noted that one of the responses was ambiguous, one was consistent with the Commission's market definition, and one advocated a broader definition but

4 Case T-221/95, Endemol Entertainment v. Commission, 1999 E.C.R. II-1299; Case 62/86, AKZO v. Commission, 1991 E.C.R. I-3359; and Case 85/76 Hoffman-La-Roche v. Commission, 1979 E.C.R. 461.

confirmed that GE's and Honeywell's gas turbines competed with each other. In these circumstances, the CFI concluded that the Commission had not committed a manifest error in defining the relevant market.

The CFI considered it irrelevant that the Commission had failed to seek information from the only European customer of each of the parties since GE had not shown or alleged that this failure affected the Commission's finding. The CFI also considered it irrelevant that Honeywell's gas turbine had competed against GE's gas turbine in a bidding process only once during the last five years, since bids in maritime gas turbines were rare.

C. STRENGTHENING OF GE'S DOMINANT POSITION IN LARGE COMMERCIAL JET ENGINES THROUGH VERTICAL FORECLOSURE

1. GE's Existing Dominance

The CFI confirmed that the Commission was correct in finding that GE occupied, pre-merger, a position of dominance in the market for large regional jet engines. The CFI discussed three key issues:

(i) whether the use of market shares as indicators of market power was appropriate in a bidding market;

(ii) whether it was correct to attribute the market share of a 50/50 joint venture entirely to GE; and

(iii) to what extent GE's reliance on GECAS strengthened its dominant position.

Market shares in bidding markets

The CFI agreed with GE that, in bidding markets where orders are large and infrequent, high market shares may not necessarily be indicative of dominance since shares may fluctuate significantly depending on recent wins and losses. At the same time, however, the CFI noted that GE had not only succeeded in maintaining its leading position over five years, but had also enjoyed the highest market share growth rate during this period. The CFI, therefore, concluded that the Commission could properly rely on GE's market shares for the assessment of its dominance. The CFI also observed that "lively competition on a particular market" does not rule out the existence of dominance.

Allocation of JV sales

The CFI confirmed that the Commission was correct in allocating the market share of CFM International (CFMI) (a 50/50 joint venture between GE and France's Snecma) entirely to GE, even though it rejected the Commission's suggestion that CFMI was a quasi-subsidiary of GE. The CFI highlighted the following elements:

- CFMI's engines did not compete with GE's engines. According to the CFI, GE and CFMI effectively acted as a single entity vis-à-vis competitors and customers.
- Snecma, unlike GE, did not and could not produce engines independently. Allocating part of CFMI's sales to Snecma, therefore, would not have reflected true market reality.
- GE's own annual reports attributed CFMI's market share entirely to GE.

Leveraging of GECAS

The CFI agreed that the Commission could treat GE's reliance on GECAS as an element that strengthened its dominance. GECAS had enabled GE to influence engine selection by airframe manufacturers and airlines and, thus, to win contracts that it would not have won through competition on the basis of price and technical quality alone. The effects of GECAS on engine competition differed depending on who selected the engine for a given aircraft type:

- If the airframe manufacturer selected the engine for a given aircraft type, GECAS's role as a large purchaser of aircraft would create a strong incentive for manufacturers to place GE engines on their new airframes, since GECAS had a well-established record of buying only GE-powered aircraft. GECAS accounted for 7-10 percent of all large commercial aircraft purchases. Aircraft manufacturers would know that if they did not select GE engines, GECAS would not purchase their airplanes and thus, they would be cut off from this portion of the market.
- If the airline selected the engine, GECAS as a leasing company could offer airlines concessions if they took GE's engines. In addition, GECAS could influence the choice of airlines indirectly by "seeding" the market with GE equipped aircrafts. Given the benefits available to airlines (e.g., in terms of lower maintenance costs) of using the same engine type across their entire fleet, GECAS's seeding policy created incentives for airlines to standardise their fleet on GE engines.

The Decision included evidence that GECAS had in fact played an important role in actual engine selection decisions by airframe manufacturers. In light of the Commission's evidence, the CFI rejected GE's objection that the Commission's economic theory (based on GECAS's relatively small share of total aircraft purchases) was "unorthodox." It was also irrelevant that the Commission had been unable to provide statistical data showing that GECAS actually had increased GE's overall market share. According to the CFI, the individual incidents described by the Commission were sufficient to demonstrate that GE had used GECAS to promote its engines and that this policy had met with success in individual cases. Moreover, GE's economists had not been able convincingly to show with their own statistical models that the use of GECAS had not had an impact on the market.

2. Strengthening of Dominance through Vertical Foreclosure

The CFI also followed most of the Commission's reasoning with respect to the risk of foreclosure arising from GE's acquisition of Honeywell's engine-starter business, but stopped short of endorsing the Commission's conclusions on this point. The CFI agreed that GE's engine competitors were dependent on Honeywell engine starters and that GE would have a commercial incentive to delay or disrupt supplies of Honeywell engine starters to its competitors post-merger. This was because engine-starter sales represented only a small fraction (around 0.2 percent) of the profits that GE could derive from additional engine sales. As a result, it would be to GE's advantage to forego profits from engine starters in order to win engine market share at the expense of its competitors.

The CFI rejected GE's objection that the Commission had not produced an "economic study" to prove GE's incentives and the likely market development. The CFI explained that where it is "obvious" that the merged entity will have the incentives to behave in a certain way, the Commission does not commit a manifest error in holding that it is likely that the merged entity effectively will behave in that way. In such circumstance, the "simple economic and commercial realities" of the case may constitute "convincing evidence" for supporting the Commission's conclusions, thus meeting the standard of proof set by the ECJ in *Tetra Laval*.

However, the CFI held that the Commission's analysis was incomplete because the Commission had failed to take into account the deterrent effect of Article 82. According to the CFI, a disruption of engine-starter supplies as contemplated by the Commission would "clearly amount to an abuse." The CFI pointed out that the abusive conduct need not take place in the market in which dominance is found to exist. It also noted that the more convincing the Commission's case on the effectiveness of the supply disruption would be, the more likely that the conduct would infringe Article 82. The need to consider the deterrent effect of Article 82 in assessing whether the strategic conduct was likely to take place was established by the CFI's judgment in *Tetra Laval* (which the Decision preceded). The CFI noted that while the Commission did not have to engage in an in-depth assessment of the deterrent effect of Article 82, it nevertheless required the Commission to undertake at least a "summary analysis based on the evidence available to it." Accordingly, the CFI concluded that the Commission had committed a manifest error of law by failing to discuss the possible deterrent effect of Article 82.

THE CFI POINTED OUT THAT THE ABUSIVE CONDUCT NEED NOT TAKE PLACE IN THE MARKET IN WHICH DOMINANCE IS FOUND TO EXIST.

D. CREATION OF A DOMINANT POSITION IN AVIONICS THROUGH CONGLOMERATE EFFECTS

As noted above, the Decision identified two types of conglomerate effects that the Commission alleged would create a dominant position in avionics:

(i) the leveraging of GECAS; and

(ii) the bundling of GE engines with Honeywell avionics.

The CFI found that the Commission's assessment was erroneous in both respects.

Leveraging of GECAS

Although, as noted above, the CFI endorsed the Commission's finding that GECAS played a role in establishing GE's pre-existing dominance in engines, the CFI held that the Commission had not provided sufficient evidence to demonstrate that GE would have extended the same practices to create dominant positions for Honeywell's avionic products. Such evidence could have consisted, for example, of an economic study of GE's incentives or documents demonstrating that GE effectively intended to use GECAS in favour of avionic products post-merger. It was not sufficient for the Commission simply to point to GE's reliance on GECAS for the promotion of engines and assume that the same mechanisms would apply with respect to avionics.

The CFI pointed out that GE's reliance on GECAS entailed costs in the form of the concessions that GECAS made to customers. In the case of engines, these costs were off-set by the revenue streams generated from after-sale services. Yet, in the case of Honeywell's avionics, the Commission had not examined whether the revenue generated from avionics sales would be capable of compensating the costs of relying on GECAS and, therefore, whether such reliance would be worthwhile for GE.

The CFI, moreover, found that the Commission had not proven that GE's reliance on GECAS for the promotion of avionic products would effectively lead to the creation of a dominant position. The Commission had ignored the fact that GECAS was only active in the area of large commercial and large regional aircraft, while Honeywell's avionic products were also sold for other aircraft. In addition, the Commission's analysis had failed to distinguish properly between the different avionics product markets. As a result, the Commission failed to demonstrate what the likely impact of the transaction would have been on each relevant market.

Bundling

Similarly, the CFI held that the Commission had not provided sufficient evidence to demonstrate that GE would have an incentive to engage in bundling of

engines and avionic products. The CFI cited the following main factors in this respect:

- The scope for bundling of engines and avionic products was limited because the two products were not always selected by the same operators: engines might be selected by the airframe manufacturer while avionics might be selected by airlines, or vice versa.

- Bundling would entail costs, since GE would lose customers that preferred a different combination or would have to give customers discounts to overcome such preferences. Yet, the Commission had not analysed to what extent the increased sales of avionic products would off-set such costs. It was important for the CFI's assessment that while GE was dominant in large commercial jet engines it still faced viable competition in this area.

- Snecma, which jointly controlled GE's CMFI engines joint venture, would have no incentive to sacrifice part of its profits in order to promote Honeywell avionics through a bundling strategy.

- The Commission could not simply point to Honeywell's past practice of bundling different avionic products as evidence of likely future engine/avionics bundling, since the price of engines was markedly higher than the price of avionics. As a result, it was not excluded that the commercial dynamics of an engine/avionics bundle were different from bundling avionics.

- It was also not sufficient simply to refer to the "Cournot effect of bundling," which describes the advantages that companies can derive from a large range of products. As the economists of one of the Commission's supporters recognised in a newsletter that GE presented to the Court, the Cournot effect requires a detailed analysis of the necessary discounts and expected shifts in sales, which the Commission had not made. According to the CFI, both pure and mixed bundling would have infringed Article 82. Yet, the Commission failed to discuss the possible deterrent effect of Article 82 even in summary form.

III. Analysis

The *GE/Honeywell* judgment provides interesting insights and valuable clarifications in a number of areas, including on the Court's standard of review, the relevance of economic evidence, the relevance of market shares, theories of vertical and conglomerate effects, the assessment of horizontal overlaps, and the interplay of merger control rules and Article 82.

The CFI's standard of review

The judgment confirms that the CFI will review closely the evidentiary basis of Commission decisions. At the same time, however, the Court will exercise restraint in reviewing conclusions drawn by the Commission from that evidence. The CFI's willingness to grant the Commission a margin of discretion in respect of questions of a complex economic nature is illustrated by the CFI's discussion of GE's dominance, issues of market definition, the competitive interaction between GE and Honeywell, and the assessment of GE's commitments.

The CFI's reluctance to annul the Decision even where it has found substantial parts of that decision to be defective is also noteworthy. The CFI's "independent pillars" theory—which conforms to a long-standing practice of the ECJ—requires appellants to bring an effective challenge against all independent grounds of a decision. Thus, the CFI was able to dismiss Honeywell's parallel appeal in summary form because it had not challenged the Decision's findings in respect of all markets.

Economic evidence

The judgment confirms that the Commission enjoys a considerable degree of flexibility in the type of evidence that can be relied on to discharge its burden of proof. The Court did not require the Commission to support its conclusions with any specific type of evidence. The judgment instead suggests that the Commission may choose among various types of evidence, including economic studies, internal documents, concrete factual examples, or responses from market participants.

THE JUDGMENT CONFIRMS THAT THE COMMISSION ENJOYS A CONSIDERABLE DEGREE OF FLEXIBILITY IN THE TYPE OF EVIDENCE THAT CAN BE RELIED ON TO DISCHARGE ITS BURDEN OF PROOF.

Conglomerate effects

The CFI's judgment does not exclude application of the Commission's conglomerate effects theory, although, in endorsing and applying the framework developed by the EC Courts in *Tetra Laval*, it confirms the high evidentiary standard that must be met by the Commission when it challenges transactions based on their conglomerate effects.

Consistent with the EC Courts' judgments in *Tetra Laval*, the CFI in *GE/Honeywell* required the Commission to demonstrate that the merged entity will be likely to engage in the conduct anticipated by the Commission. The judgment provides that the Commission must analyse the likelihood of the merged entity's future conduct on the basis of the entity's economic incentives and any factors that may deter it from adopting the conduct in question. In making its assessment, the Commission may rely either on internal documents or an examination of the parties' commercial interests in the relevant market at issue. The circumstance that one of the merging parties is engaging in similar conduct on a

different market, on the other hand, will not generally be sufficient to support an adverse finding.

As regards the assessment of the anticipated competitive impact of the post-transaction conduct, the judgment's reasoning suggests that the CFI will generally grant the Commission a margin of discretion in this respect, provided the Commission clearly identifies the relevant markets that will be affected by that conduct. However, the more distant the anticipated impact, the more doubtful it may be whether the merged entity will have the incentives to adopt the conduct in question. In such cases, the merged entity may more likely prefer to maximize short-run profits rather than pursue a policy intended to obtain possible, but uncertain, long-run gains.

Article 82

The CFI has provided some limited guidance on the application of the requirement established in the *Tetra Laval* judgments that the deterrent effect of Article 82 must be taken into account in determining the likelihood that the merged firm will engage in anticompetitive bundling or leveraging strategies.

The CFI confirms that the Commission must take into account the potentially unlawful, and thus sanctionable, nature of certain conduct as a factor that might diminish, or even eliminate, incentives for the merged firm to engage in particular conduct. The Commission is not, however, required to establish that the conduct foreseen in the future will actually constitute an infringement of Article 82 or that such an infringement would be detected and punished. The Commission is entitled to limit itself in this regard to a "summary analysis" based on the evidence available to it.

This does not, however, appear to lower the *Tetra Laval* standard of proof, as the CFI further confirmed that the Commission is required to adduce "convincing evidence" in support of any conglomerate effects theories. This might consist, for example, of actual evidence of the parties' intent to engage in the relevant conduct (e.g., based on internal documents of the parties) or economic analysis demonstrating the parties' commercial incentive to do so. ◀