Company Merger Regulatory Controls:

United States of America & the European Union

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I. Introduction

In this paper I will consider the pre-merger policies and regulations within the United States (U.S.A.) against that within the European Union (E.U.). For the most part, the U.S.A. and the E.U. have common motives for adopting merger regulations, namely to counter the potential for anti-competitive behavior that would have an adverse affect in markets. However, in the E.U., there is a unique additional policy, namely, the desire of the E.U. Member States to create a common market. It is my hypothesis that it was this additional policy objective that resulted in a more critical scrutiny by the Commissioner of the European Community in the merger attempt between the U.S.A.-based General Electrics (GE) and the E.U.-based Honeywell companies.

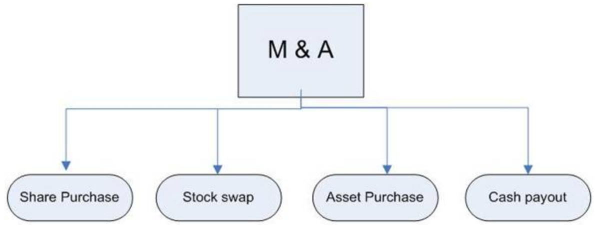
First, I will provide a brief introduction to merger and acquisitions. I will then look at why merger controls are deemed necessary. Next, I will layout the general historical development and structure of the U.S.A. and the E.U. merger regulation requirements. I will point out the key distinctions, making note of the similarities and procedural considerations.

Next, the attempted transaction of GE and Honeywell, whereby the U.S.A.-based GE entity sought to acquire the E.U.-based company Honeywell, will be examined more closely to determine why the U.S.A. approved the merger and the Commission disapproved the transaction. I will conclude with observations on how the divergence in the policies of the two regulatory jurisdictions has been addressed and how this may effect future transatlantic merger transactions.

II. Why Merger Controls?

A merger is a combination of two companies into one larger business entity. It can be voluntary, involving for instance a stock swap or cash payment to the target. It can also take form as a takeover, which is less consensual in nature, and may involve the purchase of a majority of the target company's outstanding shares in the open market.[1] Usually mergers occur in a consensual setting where managing directors from the target company cooperate with that of the company it seeks to acquire. This includes a pre-merger due diligence process to assess whether the deal is beneficial to both parties. It is often said that describing a business combination as a "merger" rather than an "acquisition" is more out of political or marketing considerations.

SOME TYPES OF MERGERS & ACQUISITIONS ("M&A")



Mergers are used as a tool by corporations to expand their operations, aiming at increased

[1] In the U.S.A., business laws vary from state to state whereby some companies have limited protection against hostile takeovers. Under the EC's Thirteenth Directive on Company Law, the level of protection given to shareholders to withstand hostile takeovers varies among Member States. This is because Member States are given the option to choose the level of protection it affords in implementing the Thirteen Directive on takeovers through its opt out provision.

efficiency for profit growth. The intent of the target company may also be the desire of the corporate actors to empire build (conglomerate). In the U.S.A., conglomerations are typically not a purpose that would raise concern under its current anti-trust policies. This is less so in the E.U.[2] The profit aim may create a desire by the potential acquirer to reduce market competition and not just increase efficiency or conglomerate. Without the intent, but with the effect, it may similarly harm a free market structure. When potential mergers aim to or have the likely effect of harmfully reducing market competition -- foreclosing the market in a way that is inconsistent with public welfare[3]-- the need for merger control comes into play.

III. U.S.A. & E.U. Merger Regulations

A. U.S.A. Merger Regulations

In the U.S.A., efficiency is still said to rein as long as it benefits consumers, and with the oversight of U.S.A. courts, several agencies share approval power for cross-border mergers. This includes mergers between the states of the U.S.A. and those involving foreign nations. Mergers within any of the states of the U.S.A. are outside the jurisdiction of the U.S.A. federal government. Both the Federal Trade Commission ("FTC") and Department of Justice ("DOJ") are the agencies primarily charged with pre-merger regulation enforcement.

The introduction of the legal fiction of a corporation under U.S.A. law developed with the notion that the use of the corporate entity was a form of public trust. Thus, contrary to how many understand the term "anti-trust", anti-competitive behavior was considered to be against the public trust (public welfare). The public welfare policy of early anti-trust law was broader than its current consumer based analysis. The U.S.A. Congress implemented the Sherman Antitrust Act of 1890[4] ("Sherman Act") to deal with the potential of this new U.S.A. legal fiction taking on behavior contrary to the public trust. The two most important provisions of the Sherman Act are Sections 1 & 2, which provide as follows:

> Section 1: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony."
>
> Section 2: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among several States, or with foreign nations, shall be deemed guilty of a felony."

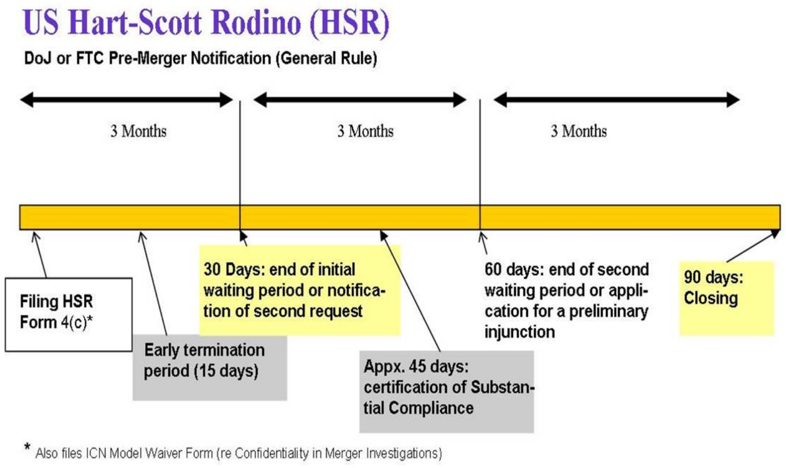
[2] See generally, Alison Jones and Brenda Sufrin, EC Competition Law, Text, Cases and Material, Second Edition, Oxford University Press, 2004 (Chapter 12 – Mergers).

[3] Public welfare is used instead of "consumer welfare" to denote that some regulatory policies have an aim that is broader than consumer welfare, for instance considering to a greater extent the harm on competitors and the employment market, as is the case generally within continental Europe. Characteristic to European civil law systems is a greater interest in instituting policies with goals of balancing the interest of various players. This is a public welfare approach or institutional model.

[4] Sherman Antitrust Act (July 2, 1890), ch. 647 Stat. 209, 15 U.S.A.C. § 1-7) (the first U.S.A. federal government action to limit monopolies).

Subsequently, the Clayton Antitrust Act of 1914[5] ("Clayton Act") was enacted in the U.S.A. to address the development of increased inter-company merger transactions. One of the goals was to address anticompetitive behavior before the merger occurred rather than after the merger. In relevant part, the Clayton Act provides that M&A's are prohibited where the effect may substantially lessen competition.[6] The key consideration of the Congressional majority of 1914 was the potential effects of such concentrations of power on the American public.

The Hart-Scott-Rodino Antitrust Improvement Act of 1976[7] ("HSR Act") is a set of additional amendments to the U.S.A. anti-trust laws. It principally aims to create procedural certainty.[8] It in essence details the notification requirements for merging entities subject to U.S.A. jurisdiction. It provides that for an acquisition transaction to close, both parties must file a "Notification and Report Form" with the FTC and DOJ. Both agencies are charged with merger enforcement. Congress created the FTC as an expert agency in competition issues. However, the DOJ was the agency initially charged with antitrust enforcement and has retained authority on competition matters as well. Thus, pre-merger HSR Act notification forms must be sent to both agencies for transactions meeting mandatory thresholds.[9]



The chart above details the procedural pre-merger notification timeline in the U.S.A. Under the HSR Act, each agency has an opportunity to review the filing and to decide whether to open an investigation. The industry expertise of a particular agency determines who procedurally opens the investigation.

Just like in the E.U., in the U.S.A. agency guidelines are also to be considered in pre-merger transactions. Though they are not binding, they provide insight on the policies the agency is pursuing.

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5 The Clayton Antitrust Act (October 15, 1914), ch. 323, 38 Stat. 730, codified at 15 U.S.A.C. § 12-27, 29 U.S.A.C. § 52-53).

6 Ibid. at § 7, codified at 15 U.S.A.C. § 18.

7 Public Law 94-435.

8 The context in which the HSR Act is usually cited is 15 U.S.A.C. § 18a, title II.

9 Companies curtail U.S.A. and E.U. pre-merger regulation if they fall below adjusted size and monetary thresholds (or aggregate turnover).

The DOJ revised its 1968 Horizontal Merger Guidelines in 1982 to incorporate new techniques for market definitions as derived from the evolving anti-trust U.S.A. Supreme Court case law.[10] The FTC released a Horizontal Merger Statement that same year, endorsing the DOJ's 1982 Guidelines and stating that the guidelines would be given considerable weight by the FTC, but that they would give "greater consideration to evidence beyond mere market shares when such evidence [was] available and in a reliable form."[11]

It should be noted that like the national laws of E.U. Member States with competency to regulate mergers, the individual states in the U.S.A. also investigate and challenge mergers under both federal and state laws with the judicial branch having the last word on challenges to mergers, where a green light has been given by the agencies. Additionally, a state government in the U.S.A. can bring an action to challenge a merger, but the states of the U.S.A. now have a diminished role in the regulation of mergers because of the increased levels of cross-state mergers.[12]

B. E.C. Merger Regulations

Suffice it to say, the E.U.'s Brussel administration is also concerned with large enterprises controlling the European markets. It has evolved from its initial focus on market shares held by the entity to a more market dynamic analysis. An initial consumer welfare focus was inherent to its common market origins. Initially, there was no particular merger regulation and Articles 81 & 82 of the Treaty of Rome was relied upon. Most of the early case law of the European Court of Justice and the Court of First Instance, whereby the E.C. began to deal with corporation's pre-merger activities, was construing these issues under Article 81. Article 81(3) of the Treaty of Rome permits any agreement:

> "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."[13]

Acts by undertakings that did not have this potential effect were said to be in contradiction to Article 81 of the Treaty of Rome. The most recent merger regulation is the EC Merger Regulation (ECMR) 139/2004.[14] It provides that the laws of the Member States apply only to concentrations that do not have a Community dimension.[15] Below is the general procedural process and time-line in the ECMR for entities aimed at affecting a merger. It is often termed the "one-stop shop" by the Commission and commentators.

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[10] The 1982 Merger Guidelines introduced the Herfindahl-Hirschman Index ("HHI"), which measures market concentration by summing the squares of the individual market shares of all participants in a market.

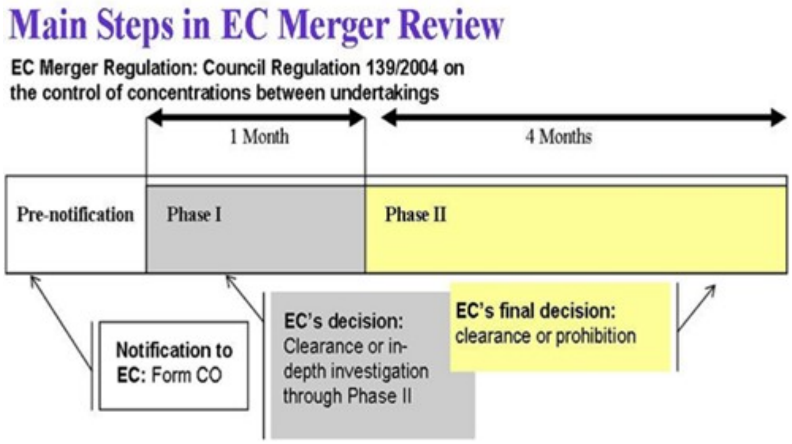
[11] David Scheffman, Malcolm Coate & Louis Silvia, 20 Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective 4, 5 (2002), available at http://www.usdoj.gov/atr/hmerger/12881.pdf (quoting the 1982 Statement of the FTC Concerning Horizontal Mergers) (last visited 3 April 2007).

[12] The states presently have a role in merger review because virtually every state has its own version of the federal Sherman Act; eighteen states have their own version of the Clayton Act, permitting them to seek to enjoin anticompetitive mergers under state law in state courts, irrespective of federal jurisdiction. It has been argued by commentators that this can lead to overlapping review of a transaction and the potential for over-regulation. Additionally, states will consider to a greater extent issues like employment and small business interests.

[13] Treaty of Rome at Article 81(3)

[14] It should be noted that a Community regulation cannot dis-apply the Treaty provision of Articles 81 and 82 to deal with pre-merger 'concentrations'. See *supra*, note 2, Jones and Sufrin, p. 896.

[15] ECMR Art 21(1).



According to ECMR Art 2(3) merger regulation seeks to catch:

> "[A] concentration which would significantly impede effective competition ("SIEC") in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position."

The standard for a violation changed from the former "creating or strengthening a dominant position" to the SIEC test. This test is like the "substantial lessening of competition" standard in the U.S.A. and is said to focus on effects rather than market dominance. The new standard suggests that the E.U., like the U.S.A., is migrating from a concentration thesis—with its strong emphasis on number of firms and market shares—to a comprehensive economic analysis of the likely impact of the transaction on competition.

Additionally, a broader policy of consumer welfare has been adopted in the E.U. While the former merger regulations of the EC adopted a dominance standard, Article ECMR 2(1) now states that in evaluating a merger the Commission shall take into account "technical and economic progress provided that it is to consumers' advantage." In his 1996 address to the European Parliament, then Commissioner Karel Van Miert announced the EC competition policy objective as aimed to address "competitiveness and development of the European economy on the one hand and consumer protection on the other hand."[16] Furthermore, in 2002, then Commissioner Mario Monti stated that both protection of consumer welfare and economic efficiency are goals of merger regulations.[17] The broader policy of consumer welfare by the Commission is shown in Brussel official's dialogues with the media, where a desire to introduce class-actions in the E.U. has been disclosed.

V. GE-Honeywell & Beyond

A brief look at the attempted merger between GE and Honeywell is instructive, because, so far, it is the only merger that was cleared by the U.S.A.[18] but derailed by the Commission. GE held a dominant position in the market for large jet aircraft engines (between 43% and 65%), which subjected

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[16] Karel Van Miert, Presentation of 25th Report on Competition Policy, Address Before the European Parliament (May 30, 1996), available at http://ec.europa.eu/comm/competition/speeches/text/sp1996_027_fr.html (last visited 3 April 2007).

[17] See Evy, Nicholas L., EU Merger Control: From Birth to Adolescence, p. 197 at http://66.102.9.104/search?q=cache:Kfkz65VxGeoJ:iep.univ-lille2.fr/lib/tele.php%3Fchemin%3D../enseignants/fichier/98-L4_EU_Merger_Control_Levy.pdf+%22protection+of+consumer+welfare%22+%26+mario+monti&hl=en&ct=clnk&cd=4 (last visited 3 April 2007).

[18] Also approved by 11 other jurisdictions.

it to particular scrutiny under Article 82 of the Treaty of Rome.[19] Honeywell had a leading position in the avionics and non-avionics aerospace component markets. According to the Commission, the merger was rejected because effective competition would be impeded mostly because unacceptable “conglomerate” effects. Additionally, it was stated that the merger raised the potential for exclusionary practices such as bundling to suppliers, in this case bundling aircraft engines with avionics, e.g., aircraft communication and navigation equipment.[20] It has been argued by some commentators that the Commission’s internal process for scrutinizing sensitive mergers allows room for political and other considerations.[21] Notably, recital 30 of the ECMR provides a legal basis for the acceptance by the Commission of commitments or remedies to proposed mergers. The Commission did not offer this option in the GE/Honeywell transaction. In contrast, the U.S.A. authorities cleared the merger, demanding limited remedies detailed in a two-page press release on May 2, 2001.[22]

The U.S.A. anti-trust agencies reacted to the Commission's decision to block GE’s proposed $42 billion acquisition of Honeywell.[23] This may have contributed to the CFI’s decision to overturn two of the Commission’s merger decisions during that period.[24] The two opinions expressed a concern for faulty-fact finding by the Commission. In any case, on May 1, 2004, the Commission's revised Merger Regulation became effective. Then Commissioner Monti noted, "[i]f there was ever a gap between [the U.S.A. and E.U.] systems, it will disappear on 1st May 2004, the date of entry into force of our new Regulation."[25] Additionally, It should be noted that a recent Commission Green Paper suggests lowering the size and financial threshold.[26] This would give the Commission jurisdiction over an increased number of mergers within the E.U.

V. <u>Conclusion</u>

The differences between the U.S.A. and E.U. regulators’ pre-merger policies became apparent in the GE/Honeywell attempted merger. These differences can be contributed to the Commission’s greater concern for competitor welfare and that competitor standing exists to challenge a prospective merger in the E.U. Consumer welfare is also of greater concern to the E.U.’s Brussel administration in

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19 Article 82 prohibits the abuse of a dominant position and not the dominant position itself.

20 The Commission feared that the strength of the combined positions of the merged companies would allow GE to engage in exclusionary product bundling with the ultimate effect of foreclosing markets for single product line competitors (particularly Rolls Royce in aircraft engines and Rockwell Collins in aerospace components).

21 See Jones and Sufrin, supra note 2, p. 909, Ftn 353.

22 The merged entity would be required to divest Honeywell’s military helicopter engine business and open up the repair, maintenance and overhaul services for certain Honeywell engines and auxiliary power units, to further competition. (See http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm) (last visited 3 April 2007).

23 Commission Decision of 3 July 2001 Declaring a Concentration to be Incompatible with the Common Market and the EEA Agreement, Case COMP/M.2220- General Electric/Honeywell, 2004 O.J. (L48) 1, see collected documents at http://www.cerna.ensmp.fr/Enseignement/CoursEUCompetionLaw/EUCompetitionLaw.htm (includes Commission press releases, notably one denying politicization of GE/Honeywell decision) (last visited 3 April 2007)

24 Case T-342/99, Airtours/First Choice Holidays, 2002 E.C.R. II-2585; Case T-310/01, Schneider/Legrand, 2002 E.C.R. II-4071; and Case T-5/02,Tetra Laval/Sidel, 2002 E.C.R. II-4381.

25 See Mario Monti, A Reformed Competition Policy: Achievements and Challenges for the future, Address Before the Center for European Reform (Oct. 28, 2004), available at http http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/04/477&format=HTML&aged=1&language=EN&guiLanguage=en (last visited 3 April 2007) ("After a constant effort during this mandate to enforce competition rules for the sake of consumers, I feel entitled to say that only a very poorly informed observer can still resort to the catchphrase that the main goal of competition policy in Europe is a different one, such as protecting competitors.").

26 Green Paper on the Review of Council Regulation (EEC) NO. 4064/89 COM (2001) 745/6 Final. See ECMR Art. 1(3) for the current jurisdictional threshold. ECMR Article 1(4) provides for a review of the thresholds by 1 July 2009.

analyzing pre-merger transactions. Comparatively, the FTC and DOJ focus more on the economic efficiency of the corporation. Additionally, during the current Bush administration, a *laissez faire* approach towards vertical and conglomerate mergers emerged.

Prior to the 2004 ECMR, transatlantic mergers were prohibitively difficult. A clear policy change emerged in the 2004 ECMR with the Commission's adoption of the SIEC test which, notwithstanding economic considerations, should encourage increased transatlantic mergers in the coming years.