Comments of
General Electric Company, United Technologies Corporation and Honeywell International Inc.
To the Federal Trade Commission and Department of Justice On the Proposed Horizontal Merger Guidelines

June 4, 2010

We are pleased to submit these comments to the Federal Trade Commission and the Department of Justice (the "Agencies") on the proposed Horizontal Merger Guidelines issued for public comment on April 20, 2010 (the "Proposed Guidelines").[1] As similarly situated multinational companies with operations subject to the antitrust laws of the United States and many other countries, General Electric Company ("GE"), United Technologies Corporation ("UTC") and Honeywell International Inc. ("Honeywell") have a strong interest in the development of sensible and sound competition policies around the world.

The 1992 U.S. Horizontal Merger Guidelines (the "Guidelines") have been among the most important and influential policy statements since the inception of antitrust law more than 100 years ago. The Guidelines' transparent, economics-based framework for merger review has been a model for merger review in the United States and, as importantly, for the development of sound policies in other jurisdictions. The Guidelines' fundamental approach to analyzing horizontal mergers has also held up very well over time. We believe any changes should, therefore, remain faithful to the current

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1 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES FOR PUBLIC COMMENT; RELEASED APRIL 20, 2010, *available at* http://ftc.gov/os/2010/04/100420hmg.pdf ("Proposed Guidelines").

Guidelines' highly successful analytical approach, focusing on those changes that are necessary to accomplish the Agencies' goals of "assist[ing] the business community and antitrust practitioners by updating and increasing the transparency of the analytical process underlying the Agencies' enforcement decisions."[2] These comments are submitted in response to the Agencies' request for "advice and suggestions from businesses, consumers, and antitrust practitioners that will assist the Agencies in ensuring the Guidelines achieve" their goals: "to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral."[3]

GE, UTC and Honeywell supply, and consume, goods and services in numerous industries and in many countries around the world. We regularly interact with the Agencies on merger matters both as third parties (suppliers and customers) and parties to proposed transactions. We look to the Guidelines as an important statement of the antitrust policies that affect business decisions in the M&A area. We believe there are several factors that have led to the Guidelines' success, and that should be carefully considered as the Agencies move toward finalizing the Proposed Guidelines:

- <u>Analytical and burden neutrality</u>. The current Guidelines have earned acceptance among many practitioners, courts, international enforcers and others, in part because they set out a largely burden-neutral analytical framework for assessing a horizontal merger's likely competitive effects, rather than describing a policy that favors challenging (or defending)

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[2] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, Request for Views on Proposed Horizontal Guidelines, at 1 (April 20, 2010), *available at* http://ftc.gov/os/2010/04/100420hmg-request.views.pdf.

[3] *Ibid.*

transactions. This is appropriate, since the vast majority of mergers, even those that combine competitors, are unproblematic and are not challenged, and most do not even require extensive investigation.

- Consensus. The Guidelines have achieved acceptance largely because they reflect consensus among the antitrust community on the fundamental analytical framework for assessing horizontal mergers, rather than attempting to "move the needle" in any particular direction or to promote policies or analytical approaches that remain controversial. A consensus-based approach builds credibility and confidence in the Agencies' policies. It also helps insulate the Guidelines from frequent reassessment by future administrations.

- International consistency. The Agencies have taken an active and highly constructive role in advocating the development of sound merger review policies abroad – leading by example, through their own processes and policies (including the Guidelines), and by promoting recommended practices in forums such as the International Competition Network.[4] We believe it is important that any revisions to the Guidelines be consistent with these international policy statements, both for the sake of the Agencies' continued credibility as advocates abroad, and because these other policies reflect well-reasoned positions that are as applicable in the United States as they are elsewhere.

[4] *See* Int'l Competition Network, Recommended Practices for Merger Analysis (April 2008 and June 2009) ("ICN Merger RP's"), *available at* http://www.internationalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf. The Agencies played a leading role in the development of these Recommended Practices, and the Department of Justice was the co-chair of the Working Group that developed them.

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In many respects, the revisions in the Proposed Guidelines are consistent with these principles, and serve well the Agencies' goal of providing better guidance to the business community and others. There are, however, several important areas where we respectfully submit that the Proposed Guidelines could be more consistent with these principles and could provide better guidance.[5]

1. Establishing burdens and unjustified presumptions. At several points, the Proposed Guidelines expressly or implicitly appear to shift the burden to the merging parties, by creating presumptions once certain conditions exist and by creating thresholds that the parties must meet. We believe an analytically neutral approach would more accurately reflect sound economics, actual agency practice (given that most horizontal mergers do not in fact raise significant concerns), and international best practices.[6] Some noteworthy examples include:

- Price-cost margins and "premium" transactional terms: The assumption in section 2.2.1 of the Proposed Guidelines that pricing "well above marginal cost … normally indicates that a firm is coordinating with its rivals or that the firm believes its customers are not highly sensitive to price," does not appear to be justified. As leading economic commentators have noted, it would be

5 In the limited time available, we provide comments on selected aspects of the Proposed Guidelines. This should not be taken to mean that we agree in all other respects with the Proposed Guidelines. A number of other issues are addressed in the Comments of the ABA Section of Antitrust Law on the HMG Revision Project (June 4, 2010).

6 *See, e.g.,* ICN Merger RP's, n. 4 *supra,* Recommended Practice I.C, Comment 1 ("An agency's merger analysis should not be a mechanical application of a legal standard based on rigid presumptions, structural criteria, or formulaic concentration numbers. An agency should apply its merger analysis reasonably and flexibly on a case-by-case basis, recognizing the broad range of possible factual contexts and the specific competitive effects that may arise in different transactions.")

erroneous to infer market power simply based on the differential between price and marginal cost – prices may significantly exceed short-run marginal cost and still reflect fully competitive pricing, particularly in industries that have significant fixed costs, for example relating to R&D or manufacturing.[7] Once all relevant costs are taken into consideration, what may appear to be "high" margins based on short-run marginal costs may in fact reflect competitive pricing with margins that cover the costs that a firm must recoup in order to continue to invest, innovate, and compete.

Similarly, the Proposed Guidelines' contention that generous financial terms and, in particular, "a high purchase price may indicate […] the acquiring firm is paying a premium to reduce competition or that the acquired firm has assets not easily replaced" does not appear to reflect mainstream economics or market realities. In our experience, the determination of an appropriate purchase price is typically a function of a multitude of objective and subjective factors, including (pro-competitive) synergies, access to financing, type of deal, or simply the price that a bidder is prepared, for pro-competitive reasons, to pay for a desirable technology or product. Observations relating to financial terms of a transaction certainly cannot in our view create any presumption of anti-competitive effects or market power.

- Market share-based presumptions: While the Proposed Guidelines adjust the current Guidelines' market share thresholds to make them somewhat more consistent with actual enforcement practices, we believe the Proposed

[7] *See* Carl Shapiro, *Testimony Before Antitrust Modernization Commission* (Nov. 8, 2005) at 7, available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Statement_Shapiro.pdf.

Guidelines would be more consistent with mainstream economic thinking, and with international best practices, if they placed significantly less reliance on market concentration in section 5.3. The consequence of the presumption of anticompetitive effects in "highly concentrated" markets is to shift the burden to the merging parties to rebut the presumption "by persuasive evidence showing that the merger is unlikely to enhance market power." We do not believe this burden-shifting is supported empirically, nor is it consistent with the Agencies' merger review practice in which many mergers exceeding these thresholds are cleared, sometimes without an in-depth review. It would appear to be more accurate and analytically useful if the Proposed Guidelines were to suggest that the higher the levels of market concentration resulting from the merger, the closer the scrutiny the merger will receive to determine its likely competitive effects. This would reinforce the central requirement that competitive effects be assessed in all cases.

- Presumptions of unilateral effects. Section 6 of the Proposed Guidelines creates a framework for analyzing unilateral effects in horizontal mergers that appears to assume that anticompetitive price effects are likely when certain conditions are met. In a case involving differentiated products, section 6.1 relies heavily on the pre-merger "diversion ratios" between the merging parties' (and, to a lesser extent, other competitors') products, and on the profitability of such diverted sales, to reach initial conclusions about likely price effects.[8] While such an analysis may be an appropriate screening tool in some circumstances for determining whether a merger might warrant closer scrutiny, we believe the Proposed Guidelines' apparent inference of upward pressure on prices, based in large part on information such as win/loss data and margins that may in fact provide little indication of actual post-merger price effects, is inappropriate.

In addition, we believe that section 6.1 sets an artificially high bar for assessing competitor repositioning by referring to the analysis of new entry in section 9. "Repositioning," by definition, applies to incumbent firms whose products already compete with the merging firms' products. Adjusting those products, or the manner in which they are marketed or sold, in order to make them more competitive with other products is routine in many industries, and will often be much more readily accomplished than would *de novo* entry by a new supplier. Finally, although academic discussions of the "upward pricing pressure" approach that forms the basis for much of section 6.1 point out that cost reductions attributable to the merger will directly reduce the potential for anticompetitive price effects, section 6.1 as drafted does not appear to acknowledge the role of efficiencies in the analysis.

Similar concerns exist with the discussion in section 6.2 relating to unilateral effects involving bargaining and auctions. One could interpret this discussion as creating an unjustified presumption of anticompetitive effects based on the mere fact that the parties are competitors, as would be the case in

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[8] *See, e.g.,* section 6.1, Example 18, which concludes that given the diversion ratios and margins of the relevant products, the parties to the merger "would raise prices 10% given the product offerings and prices of other firms."

any horizontal merger: "A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer…."

2. Departure from analytical consensus. We believe the Proposed Guidelines depart from mainstream antitrust analysis in some areas, including:

- Reduction in product "variety" as an independent anticompetitive effect. Section 6.4 of the Proposed Guidelines describes a theory of competitive harm based on whether the merger will reduce product variety because it leads the merged firm to cease offering one or more of the products sold prior to the merger. We respectfully suggest that this new theory should not be included in the Proposed Guidelines. First, the theory as articulated in the Proposed Guidelines would appear to lack any meaningful standard enabling the parties to anticipate whether their proposed merger would be viewed as likely to result in anti-competitive effects through a "reduction in product variety." Many mergers result in a combination of product lines that reduce the number of the parties' pre-merger products or lead to the discontinuation of one or more of their brands. Often the merged firm will launch new products combining complementary technologies in pre-merger product lines, or reposition products to provide a fuller range that better serves customers. All of these quite typical (and pro-competitive) post-merger actions may result in the loss of products that some customers may have valued prior to the merger. The Proposed Guidelines appear to offer no guidance on when such actions will be viewed as potentially harming consumers by "ceas[ing] offering one of the relevant products sold by the merging parties," or how any post-merger "increase [in] variety" of products would be weighed against an alleged loss of "variety" from the elimination of pre-merger products or brands.

Second, this new theory would seem to lack an established economic foundation. We are unaware of any precedent, in economics or U.S. enforcement practice, finding anti-competitive effects associated with a "reduction in product variety" apart from a traditional analysis of whether the merger would result in the creation or strengthening of the merged entity's market power, including an ability to raise prices. Finally, we believe that the addition of such an amorphous new basis for challenging mergers would be ill-advised in light of the Proposed Guidelines' international significance. Other jurisdictions could invoke this theory to justify a departure from an economics-based assessment of competitive effects in reviewing horizontal mergers. This would undermine the progress that has recently been made by the international competition community toward convergence on horizontal merger analysis that is firmly grounded in an economics-based assessment of proposed mergers.

- <u>Coordinated effects</u>. Section 7 of the Proposed Guidelines reduces the analytical guidance provided in the current Guidelines' assessment of potential coordinated effects. This in effect makes the initial assessment of market shares and concentration potentially even more important, since, under section 7.1 of the Proposed Guidelines, once the Agencies have identified a merger in a moderately or highly concentrated market that they believe may raise coordinated effects concerns, they may challenge the merger "even without specific evidence showing precisely how this will happen." The Agencies need only a "theory they deem plausible" of how the merger may cause anticompetitive effects. These and other proposed changes to the Guidelines' coordinated effects analysis create some tension with mainstream economic analysis and with international best practices. There is a broad consensus that market shares and concentration are only a starting point for the analysis of coordinated effects, and that enforcers should have valid theories of anticompetitive effects that are supported by the evidence.[9]

For example, the ICN Recommended Practices for Merger analysis that were developed under the leadership of the Antitrust Division and have been endorsed by both Agencies provide a set of criteria that should be followed in assessing the potential for coordinated effects: "In conducting coordinated effects analysis, agencies should assess whether the conditions that are generally necessary for successful coordination are present: (a) the ability to identify terms of coordination, (b) the ability to detect deviations from the terms of coordination, and (c) the ability to punish deviations that would undermine the coordinated interaction." ICN Merger RP VI.B. These criteria are discussed in the Agencies' current Guidelines, and should be retained.

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9 *See, e.g.,* ICN Merger RP II.B, Comment 3 ("Agencies should not make enforcement decisions to prevent or remedy a merger solely on the basis of market shares and concentration…. A detailed analysis of other market factors and of theories of unilateral and/or coordinated effects should always be required before definitive conclusions are drawn regarding the likely competitive effects of a merger.")

3. Departure from international norms and recommended practices. There are several areas where the Proposed Guidelines arguably are in tension with practices and policies that the Agencies have advocated, and that have gained acceptance, abroad. Some of these have been noted above – e.g., what could be interpreted as creating certain presumptions in the unilateral effects analysis, changes in the coordinated effects analysis, and the introduction of a theory of harm based on a reduction in "product variety."

Another area of tension with the Agencies' international recommendations is the Proposed Guidelines' downplaying of the role of market definition in merger analysis. ICN Merger RP IV.A, Comment 2 states that "Agencies generally should conduct competitive effects analysis within the context of properly defined product and geographic markets. However, market definition is not an end in itself but is a tool to assist in determining whether a merger will create or enhance market power." We recognize that the Proposed Guidelines discuss market definition as one of the various tools of merger analysis, and we believe it is likely that the agencies will continue to employ market definition to some degree in most of their merger investigations. At the same time, to the extent that the Agencies may seek to reduce the role of market definition in some investigations – for example, when they believe they can directly measure unilateral price effects as suggested in section 6.1 of the Proposed Guidelines – then the risk is not only that the Agencies may fail to include a market definition "reality check" in their own investigations that would help screen out potentially weak cases, but also that they may inadvertently encourage less rigorous analysis abroad. Even assuming the Agencies have the requisite data and analytical tools to measure anticompetitive effects “directly” in some cases, the widespread adoption of such an approach internationally could lead to less rigorous and less transparent merger enforcement.

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We appreciate the opportunity to offer these comments, and we would welcome the opportunity for continued discussions with the Agencies as they move toward finalizing the Proposed Guidelines.