THE DEPARTMENT OF DEFENSE’S ROLE IN MERGER REVIEW

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I. INTRODUCTION

While defense industry mergers are reviewed by the Department of Justice ("DOJ") or the Federal Trade Commission ("FTC" and together the "antitrust agencies"), there is another government agency that can play a key role in the outcome of the merger review process. Within the Department of Defense, ("DoD") the leanly-staffed Office of Industrial Policy’s Mergers and Acquisitions Program (the “Office of Industrial Policy”, or OIP) reviews deals in or affecting the defense industry. The Office of Industrial Policy is much smaller than the antitrust agencies. Its findings are generally not publicly disclosed, although the Office’s website and public statements explain some of its methodology. The Office of Industrial Policy conducts assessments to support the antitrust agencies, coordinates input from across the DoD, and “generally opposes mergers that overly reduce or eliminate competition, limit innovation, raise credible threats to national security, and are not in the [DoD]’s best interests.” In conducting these assessments, the Office of Industrial Policy ensures that “[DoD’s] interests are protected.” The Office of Industrial Policy yields significant influence over the fate of defense deals.4

This article provides an overview of the organization and leadership of the Office of Industrial Policy and discusses its involvement in the antitrust review process.

II. CURRENT LEADERSHIP AND RECENT REORGANIZATION

The DoD has used the OIP to review mergers since 1994, but the office was affected by a 2018 DoD reorganization. Previously, the DoD’s merger review office was located under the Office of Manufacturing and Industrial Base Policy ("MIBP"), which itself operated under the Office of the Under-secretary of Defense for Acquisition, Technology and Logistics ("AT&L"). The 2018 reorganization renamed the MIBP the Office of the Deputy Assistant Secretary of Defense for Industrial Policy. It also split the AT&L into two offices: The Office of the Undersecretary of Defense for Research and Engineering ("R&E") and the Office for Acquisition and Sustainment ("A&S").

Appointed in 2017, the previous Undersecretary of Defense for AT&L, Ellen Lord, has transitioned to her new role as Undersecretary of Defense for Acquisition and Sustainment. The Office of Industrial Policy acts as the “principal advisor” to the A&S for antitrust reviews of mergers and acquisitions.
The current director of M&A within the Office of Industrial Policy is Jonathan Wright. Wright, who has a business rather than a legal background, holds a BS degree in Finance from Hampton University, and an MBA from the University of Maryland. Prior to his current role Wright worked as an investment banker on Wall Street, had private defense experience from positions at Northrop Grumman and Huntington Ingalls, and served as a business analyst for the Naval Sea Systems Command in the DoD.5

III. THE AUTHORITY AND POWER OF THE OFFICE OF INDUSTRIAL POLICY

The Office of Industrial Policy derives its authority to review mergers from DoD Directive 5000.62, which calls for a review of mergers and acquisitions involving major defense suppliers. The Directive calls for consideration of the impact of a defense merger on national security, access to critical inputs, the impact on DoD contracting, technologies, and innovation, as well as more traditional economic analyses of proposed transactions.6 DoD’s involvement in the review process also covers transactions between non-defense suppliers where the DoD is a significant customer.7

The Directive provides that the Office of Industrial Policy should cooperate with the antitrust agencies in its review of mergers and work alongside attorneys from the general counsel’s office for the DoD and the Deputy Assistant Secretary of Defense for Industrial Policy. Said cooperation may include participation in interviews conducted by antitrust enforcers with the merging parties and interested third parties, review of the merging parties’ internal documents by the DoD, and coordination between DoD experts and the antitrust agencies.8 According to Wright, the antitrust agencies “lean on us to make sure they are getting the right information” and “are really helpful and sympathetic to making sure DoD’s interests are taken seriously.”9

Wright’s predecessor in his role, Stephen Hull, has also given some insight into the DoD’s merger review process. Hull explained in an interview that the antitrust agencies give a lot of weight to complaints from the Pentagon regarding the competitive effects of a deal and, in instances when DoD is the only domestic customer involved, complaints from the Pentagon can carry nearly dispositive weight.10 The ultimate ability to bring enforcement actions and challenge mergers lies with the antitrust agencies, not the DoD. However, Hull noted that when the Pentagon objects to a deal “[i]t gives the DOJ and FTC a good customer who is willing to step forward, provide data and other evidence, and take the witness stand.”11 This gives the DoD the ability to influence the DOJ’s and FTC’s enforcement decisions in a significant way. Hull added that defense companies often walk away from mergers when his office objects.12 However, the DoD does not have a blanket policy of preventing potentially problematic deals. As with the antitrust agencies, divestitures and other remedies can often resolve the DoD’s competition concerns.

9 Id.
10 But see FTC v. Alliant Techsystems Inc., 808 F. Supp. 9 (D.D.C. 1992). The Army supported and provided testimony in favor of a merger to monopoly of the only two U.S. manufacturers of 120 millimeter tank ammunition but the FTC successfully sued to enjoin the merger forcing the parties to walk away.
11 Id.
12 Id.

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IV. THE OFFICE OF INDUSTRIAL POLICY’S RECENT ANTITRUST REVIEWS

The Office of Industrial Policy reviews “only the transactions with a potential impact to DoD interest[s].”13 In FY2017, the Office of Industrial Policy reviewed 13 deals ranging from large transactions between prime government contractors to smaller deals where DoD was a significant, but by no means the only, customer invested in the outcome of the transaction. The Office of Industrial Policy’s assessment of transactions is not typically publicly reported.

Prime contractor deals reviewed by the Office of Industrial Policy included United Technologies’ $30 billion acquisition of Rockwell Collins, Northrop Grumman’s $7.8 billion acquisition of Orbital ATK, and Ultra Electronics’ acquisition of Sparton Corporation for $235 million.14 The DOJ required that United Technologies/Rockwell divest two businesses involved in aircraft safety, while the FTC required Northrop Grumman/Orbital ATK to erect a firewall between its solid rocket motor business and the rest of the merged company and offer those products to competitors on non-discriminatory terms. Each of the remedies was likely identified by the OIP, which can request that the antitrust agencies pursue specific remedies to protect the Pentagon’s interests as a customer. Finally, Ultra Electronics and Spartan Corporation walked away from their deal after the DOJ expressed concerns over the loss of competition between the only viable suppliers of sonobuoys – buoys which detect underwater sounds – to the Navy.

As noted above, the Office of Industrial Policy will also review mergers outside of the defense sector where the DoD is a significant customer of the merging parties. For example, in FY2017, the OIP reviewed mergers of cooking oil suppliers with implications for the Department of Defense Commissary Agency, prosthetic limb suppliers impacting Walter Reed and the Defense Health Agency, as well as in industrial machinery suppliers, specialty chemical suppliers, airline passenger safety, and aviation fuel filtration.15

The antitrust agencies challenged no fewer than five of these transactions.16 Notably, the FTC successfully litigated a preliminary injunction in a specialty chemicals merger, utilizing a witness from Military Sealift Command who testified as to the particular needs of the department.17 Also of note, two of the transactions reviewed in FY2017 fell below the HSR review threshold. In the first, the Office of Industrial Policy reviewed the acquisition of an airline passenger safety restraint business acquired by TransDigm. After a post-closing review, the DOJ required TransDigm to divest two acquired entities that manufacture these restraint systems, restoring competition in a highly concentrated industry with only two major suppliers. The Office of Industrial Policy also reviewed Otto Bock’s recent acquisition of FIH Group Holdings, the prosthetic supplier merger noted above, even though HSR thresholds were not met. The companies are two of the top prosthetics manufacturers in the country. The FTC has challenged the merger and the dispute is ongoing before an administrative law judge.

V. HOW THE REVIEW STANDARD DIFFERS FROM ANTITRUST AGENCIES

The Office of Industrial Policy considers national security and the DoD’s specific procurement needs in its antitrust review. These considerations are not equivalent to the traditional consumer welfare standard considered by the antitrust agencies, which can result in disagreements between the OIP and the agencies. Partly for this reason, in late 2015 the DoD announced legislative proposals to grant regulators the ability to block mergers

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14 Id.

15 Id.


The FTC and DOJ subsequently issued a joint statement saying that the antitrust agencies’ merger reviews would consider national security interests to the extent that “a transaction threatens to harm innovation, reduce the number of competitive options needed by the DoD, or otherwise lessen competition.”

Apparently satisfied by the antitrust agencies’ response, DoD withdrew those proposals, but the episode illustrates potential tensions that can develop between the antitrust agencies and the DoD in the area of merger review policy.

VI. DOD CONCERNS ABOUT CONSOLIDATION IN THE DEFENSE INDUSTRY

The Office of Industrial Policy’s focus on DoD interests and national security needs means that the Office will continue to play an active role in the defense industry going forward, and the Office’s scrutiny of defense deals will be particularly focused on mergers between large prime contractors. In recent years, DoD has been increasingly vocal about its concerns over growing consolidation among prime defense contractors. In its 2017 Annual Industrial Capabilities Report, DoD explained that:

The trend toward fewer and larger prime contractors has the potential to affect innovation; narrow industrial capabilities and technology; limit the supply base; pose entry barriers to small, medium, and large businesses; and ultimately reduce competition that may otherwise not be in the Department’s or the public’s interests. The Department is mindful of past loss of competition at the prime level, resulting from significant industry consolidations over the past 20-plus years.

Indeed, DoD has for several years publicly identified defense industry consolidation as a key risk to its operations. DoD has reported that it “relies on robust, credible competition to provide high-quality, affordable, and innovative products. . . . The Department has been concerned about M&A among the top tier of weapons suppliers for some time and does not view consolidation among our top weapon system primes as a favorable development.” Consistent with this view, the then-Undersecretary of Defense for AT&L, Ellen Lord, stated at her Senate nomination hearing:

Although I believe that the Department should not have a blanket policy of discouraging further consolidation or divestiture, or encouraging a specific industry structure, it is difficult to foresee supporting further consolidation of our principal weapons-system prime contractors. It should continue to be the Department’s policy to oppose business combinations (mergers, acquisitions, or joint ventures) that are not in its ultimate best interest and represent harm to our Nation’s security.

Lord’s statements follow a trend set by her predecessors, including the former head of the AT&L, Frank Kendall, who commented in 2015 that, “[t]he trend toward fewer and larger prime contractors has the potential to affect innovation, limit the supply base, pose entry barriers to small, medium and large businesses, and ultimately reduce competition — resulting in higher prices to be paid by the American taxpayer in order to support our warfighters.”

These concerns are likely to play a key role in the Office of Industrial Policy’s review of defense industry mergers, and keep the office at the center of the antitrust review process.

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21 FY 2016 Annual Industrial Capabilities Report at 103.


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