

THE NATIONAL LAW REVIEW

Published March 10, 2022, at NatLawReview.com

Defense Department Takes Aim at Anticompetitive Mergers in Defense Industry

Says market concentration poses a national security risk.

By Jennifer M. Oliver



In 1990, the Department of Defense could turn to 13 companies to produce tactical missiles, eight to make fixed-wing aircraft, and another eight to build ships. Now there are only three missile and three aircraft makers, and only two surface ship builders. There were eight satellite manufacturers in 1990; today there are only four. Tanks and other tracked vehicles are now made by a single company.

Such market consolidation is potentially harmful for the usual reasons, such as less innovation, higher prices, and a lower level of customer service. But when that customer is the DOD, having only one or a handful of defense equipment makers, suddenly critical military missions, military and civilian lives, and national security are put at risk, “[P]articularly in cases where the existing dominant supplier or suppliers are influenced by an adversary nation”

That is the worrisome assessment contained in a report issued by the DOD which is following up on President Biden’s July 2021 executive order, titled “Promoting Competition in the American Economy.” DOD is just one of the agencies now responding with plans to evaluate their respective competitive landscapes and to make recommendations to restore productive rivalries.

If market consolidation suggests harmful anticompetitive conditions, then the defense industry’s merger history should send up multiple flares. “Since the 1990s, the defense sector has consolidated substantially, transitioning from 51 to 5 aerospace and defense prime contractors,” the report says.

DOD offers five general recommendations to increase defense industry competition:

- > **Strengthen Merger Oversight.** When a merger threatens DOD interests, DOD will support the Federal Trade Commission and Department of Justice in antitrust investigations and recommendations involving the defense industry.
- > **Address Intellectual Property Limitations.** Certain practices surrounding intellectual property and data rights have been used to limit competition in DOD purchasing and to induce “vendor-lock” and other undesirable results. DOD says it will identify its long-term intellectual property needs early in the bidding process. This should ensure that intellectual property is a key factor in evaluating competitive awards, and a negotiation objective in sole-source awards and when

contracting with vendors willing to provide the government the intellectual property and rights it needs.

- > **Increase New Entrants.** To counteract the shrinking list of contractors, DOD says it will work to attract new entrants to the defense marketplace by reducing barriers to entry. This will be accomplished through small business outreach and support. DOD says it will use “acquisition authorities” that will give it the flexibility to adopt and incorporate commercial best practices to reduce barriers and attract new vendors.
- > **Increase Opportunities for Small Businesses.** DOD will increase small business participation in defense procurement, with an emphasis on increasing competition in priority segments of the defense industry.
- > **Implement Sector-Specific Supply Chain Resiliency Plans.** DOD calls for greater resilience in the supply chain for five priority sectors: casting and forgings, missiles and munitions, energy storage and batteries, strategic and critical materials, and microelectronics.



Abrams Main Battle Tank manufactured by General Dynamics, the sole producer of tanks and other tracked combat vehicles for the Department of Defense. Photo from General Dynamics’ website.

In June 2021, Bradley Martin, Ph.D., a retired Navy captain now with the RAND National Security Supply Chain Institute, wrote of the dangers of the defense industry’s shift to practices that make resupply of military equipment “highly questionable” should demand for equipment suddenly spike.

“If evaluated solely against meeting steady-state demand, the military operational supply chain works as it should,” Martin wrote. “The problem is not performance relative to incentives. Rather, the problem is that the existing guidance does not lead the system to conduct analyses and make decisions needed to support the highly demanding combat operations likely in a conflict with a major power. As a result, the ability of this system to properly support the joint force in the event of major conflict is at best untested and could be highly problematic.”

Recent Public and Private Actions

In addition to the government’s focus on the overall industry, it has been taking action to address specific instances of alleged and potentially anticompetitive behavior. In one instance, a private class action quickly followed.

In January, the FTC sued to stop Lockheed Martin Corp.’s \$4.4 billion acquisition of Aerojet Rocketdyne Holdings Inc., marking the first time in decades the government opposed a defense industry merger. (Read *FTC Sues to Torpedo Lockheed’s \$4.4 Billion Aerojet Acquisition* on the MoginRubin Blog.)

The FTC noted that Aerojet, which reported more than \$2 billion in 2020 revenue, is the last independent U.S. supplier of defense-critical missile propulsion systems. If the deal were to go through, the FTC said, “Lockheed will use its control of Aerojet to harm rival defense contractors and further consolidate multiple markets critical to national security and defense.”

Lockheed leads the pack of the largest defense contractors in the world. It is one of the leading suppliers of missile technology in a concentrated group that includes Raytheon Technologies, Inc., Northrop Grumman Corporation, and The Boeing Company. All are missile system prime contractors to the Department of Defense. The FTC says these companies are intermediaries between the U.S. government and the missile supply chain, including subcontractors like Aerojet.

In December 2021, a federal grand jury in Connecticut returned an indictment charging a former manager of leading aerospace engineering company Pratt & Whitney, Inc., and five executives of outsource engineering suppliers for participating in a long-running conspiracy to restrict the hiring and recruiting of employees among their respective companies. (Read *Aerospace Execs Indicted for Conspiracy to Limit Worker Pay and Job Prospects* on the MoginRubin Blog.)

The conspiracy is said to have affected thousands of engineers and other skilled workers in the aerospace industry who perform services in the design, manufacturing, and servicing of aircraft components for both commercial and military purposes. According to the felony indictment, unsealed in U.S. District Court for the District of Connecticut, six individuals conspired with others to allocate employees by agreeing not to hire or solicit professionals from each other’s ranks.

Following the indictment, a jet engine mechanic formerly employed by Pratt & Whitney filed a class action suit in federal court in Connecticut against the company and five outsource engineer suppliers. The plaintiffs seek damages because of the alleged conspiracy to suppress labor costs and hamper employees’ career prospects using illegal no-poach agreements in violation of antitrust laws.

Ukraine Invasion Demonstrates 'Rapid Escalation'

Combined with Russia’s invasion of Ukraine and the alarming specter of a widening conflict, security supply chain expert Bradley Martin’s assessment that the industry may not be set up to address a spike in demand for military equipment illustrates why the DOD’s plan to improve competition in the defense industry is an urgent one.

“The Ukraine crisis shows that situations can rapidly escalate, potentially leading to situations where spikes in demand might occur in largely unexpected ways,” Martin told the MoginRubin Blog. “If the U.S. had to deal with an expanded conflict in Europe, such as might occur if Russia were to threaten a NATO ally, DOD could reallocate munitions and supplies for some period, but expanding production and inventory over a longer period would be very challenging. This would likely be exactly the kind of conflict where low-standing issues with supply chains would show themselves, sometimes in unexpected ways.”

Defense is just one of several industries seeing increased scrutiny from enforcers. Healthcare also has been a focus of late (see the MoginRubin Blog post regarding FTC’s action to stop a New England hospital merger). The technology sector is getting attention, too. Chipmaker Nvidia called off its vertical acquisition of Arm Ltd. following an FTC challenge to the deal (see our February post on the MoginRubin Blog). A recent Treasury Department report on the alcoholic beverage industry foreshadows greater attention from the FTC and DOJ regarding deals in that sector.

In October the FTC said it was bringing back its policy of routinely restricting anticompetitive mergers, putting “industry on notice” that it will require aggressive acquirers to obtain prior approval “before closing any future transaction affecting each relevant market for which a violation was alleged, for a minimum of 10 years.” The agency is clearly making good on its promise.



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