UNITED STATES OF AMERICA
Federal Trade Commission
WASHINGTON, D.C. 20580

Office of the Chair

The Honorable Elizabeth Warren
United States Senate
309 Hart Senate Office Building
Washington, D.C. 20510

Aug. 6, 2021

Dear Senator Warren:

Thank you for your letter outlining concerns about monopolistic behavior of firms in the defense industry and requesting that the Federal Trade Commission re-evaluate the best method to protect fair competition when analyzing vertical deals. I appreciate receiving your views as well as your suggestions for how to improve the Commission's track record when it comes to stopping harmful mergers.

I agree that the Commission should have no tolerance for unlawful mergers. I also share your skepticism about the efficacy of behavioral remedies. Indeed, both research and experience suggest that behavioral remedies pose significant administrability problems and have often failed to prevent the merged entity from engaging in anticompetitive tactics enabled by the transaction.[1]

While the antitrust agencies have at times relied on behavioral remedies, both the Commission and the Department of Justice have a stated preference for structural remedies, even for vertical mergers.[2] This preference is consistent with what Congress expects.[3] Courts have also widely acknowledged that divestiture is the presumptive remedy for an acquisition found to be illegal under Section 7 of the Clayton Act.[4] The Supreme Court in *du Pont* described divestiture as "the most important of antitrust remedies. It is simple, relatively easy to administer, and sure."[5]

While structural remedies generally have a stronger track record than behavioral remedies, studies show that divestitures, too, may prove inadequate in the face of an unlawful merger.[6] In light of this, I believe the antitrust agencies should more frequently consider opposing problematic deals outright.

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[1] *See, e.g.*, John E. Kwoka & Diana L. Moss, *Behavioral Merger Remedies: Evaluation and Implications for Antitrust Enforcement*, 57 ANTITRUST BULL. 1, 24 (2012).
[2] U.S. DEP'T OF JUST., MERGER REMEDIES MANUAL, 16 (Sept. 2020) ("Structural remedies are strongly preferred in horizontal and vertical merger cases because they are clean and certain, effective, and avoid ongoing government regulation of the market.").
[3] *California v. American Stores Co.*, 495 U.S. 271, 284-85, n. 11 (1990) ("As the Supreme Court has explained, Congress "made express its view that divestiture was the most suitable remedy in a suit for relief from a §7 violation: In §11 of the [Clayton] Act, Congress directed the FTC to issue orders requiring that a violator of §7 'cease and desist from the violation,' and, specifically, that the violator 'divest itself of the stock, or other share capital, or assets, held' in violation of the Act.").
[4] *See, e.g.*, *United States v. E.I. du Pont de Nemours & Co*., 366 U.S. 316, 326-27 (1961); *United States v. Greater Buffalo Press*, 402 U.S. 549, 556 (1971); *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972).
[5] 366 U.S. at 330-31.
[6] *See* JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY, 115-120 (1st ed. 2015) (concluding that even when antitrust agencies obtained asset divestitures, price increases averaged approximately 7%).

With that general background, I now turn to your specific questions regarding vertical mergers in the defense industry.

1. What is the DoD's role, if any, when the FTC assesses transactions in the defense industry? Is the DoD's approval necessary for such transactions?

As the primary (and in many cases, sole) customer for many products and services sold by defense firms, the DoD plays an important consultative role in the Commission's (or DOJ's) review of proposed defense mergers notified under the Hart-Scott-Rodino Act.[7] The DoD also supports the agencies' investigations in this sector, with staff dedicated to reviewing proposed mergers and joint ventures.[8] Ultimately, however, it is the antitrust agencies that determine whether a transaction should be challenged, and DoD approval is not required prior to consummation.[9]

2. How many transactions in the defense industry have been subjected to behavioral remedies by the FTC since 2000?

Since 2000, the Commission has issued orders in five defense mergers: Boeing/Hughes (2000); GenCorp Inc./Sequas Atlantic Research Corp (2003); General Dynamics/SNC Technologies (2007); Boeing/Lockheed Martin ULA Joint Venture Alliance (2007), and Northrop Grumman/Orbital ATK (2018). Of these, only the most recent, Northrop Grumman/Orbital ATK, contained solely behavioral remedies. For the others, there were significant horizontal as well as vertical issues, which led enforcers to require divestitures or other provisions.

3. On average, how long do the requirements of these behavioral remedies last?

FTC orders that primarily contain conduct or behavioral remedies, i.e., orders that are not divestiture orders with ancillary conduct provisions, generally last 20 years.[10] For example, the Northrop Grumman/Orbital ATK order lasts for 20 years, expiring in 2038.

4. How often has the FTC completed retrospective reviews of vertical transactions in the defense industry?

To my knowledge, the FTC has never conducted a retrospective review of any vertical transaction in the defense industry.[11]

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[7] The DoD often has special expertise and knowledge about the merging parties and markets at play.
[8] Consistent with the DoD policy, the agency also makes its own assessment of the likely competitive effects of a merger. *See* U.S. DEP'T OF DEF., DIRECTIVE 5000.62, REVIEW OF MERGERS, ACQUISITIONS, JOINT VENTURES, INVESTMENTS, AND STRATEGIC ALLIANCES OF MAJOR DEFENSE SUPPLIERS ON NATIONAL SECURITY AND PUBLIC INTEREST (2017). The Commission remains committed to giving the DoD's assessment due weight where appropriate.
[9] Joint Statement of Dep't of Just. & Fed. Trade Comm'n on Preserving Competition in the Defense Industry, 2 (Apr. 12, 2016), https://www.ftc.gov/public-statements/2016/04/joint-statement-department-justice-federal-trade-commission-preserving (quoting the Report of the Def. Sci. Task Force on Antitrust Aspects of Defense Industry Consolidation (1994)) ("The antitrust agencies should continue to determine the ultimate question of whether a merger of defense contractors should be challenged on the ground that it violates the antitrust laws.").
[10] *See* Fed. Trade Comm'n, Pol'y Statement Regarding Duration of Competition and Consumer Protection Orders (Aug. 16, 1995), https://www.ftc.gov/sites/default/files/attachments/merger-review/950816durationofcompetitionandconsumer.pdf.
[11] The FTC's Bureau of Economics maintains a list of all merger retrospectives that have been published in academic journals or released by a government organization. *See Merger Retrospective Studies Bibliography*, FED. TRADE COMM'N, https://www.ftc.gov/policy/studies/merger-retrospectives/bibliography (last visited Aug. 6, 2021).

Others have raised concerns about the shrinking number of defense firms.[12] A 2019 report from the Government Accountability Office reports that nearly half of DoD contracts are awarded to five companies: Lockheed; Boeing; General Dynamics; Northrop Grumman, and UTC.[13]

5. What rules, mechanisms, or standards does the FTC abide by or employ to select compliance officers or monitors to ensure parties meet the requirements of a behavioral remedy?

The FTC's general practice has been to choose monitors based on their industry expertise and their lack of financial or other ties to the company under order.[14] The FTC has historically relied on staff working with monitors to guard against order violations. The efficacy and resource intensity of this approach raises several concerns for me, and I am examining whether the FTC should continue this practice.[15]

6. What rules, mechanisms, or standards does the FTC abide by or employ to determine that a behavioral remedy would protect competition once a vertical transaction has been consummated? Please include any considerations of relevant market shares, Herfindahl-Hirschman Index calculations, and revenues of the parties.

The Commission has broad remedial powers to write and enforce orders[16] and I believe the Commission must use all its powers to prevent abusive anticompetitive conduct and illegal mergers. This remedial flexibility is critical if the Commission is going to address head-on the severe problems created by increasing levels of concentration. The methods of subverting competition are numerous and subtle, and writing effective orders to prevent them is key to the Commission's success – or failure.

As noted above, I am skeptical that behavioral remedies alone are sufficient to prevent a vertical merger from causing harm. This is especially true for vertical mergers involving large firms with substantial market power at one or more levels of the supply chain. The larger the market share, the higher the risk that a vertical merger will result in a reduction of competition post-merger. For that reason, I prefer structural remedies that prevent the harmful integration of assets, or would support the Commission moving to block the merger altogether.

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[12] *See* Mark Thompson, *The Incredibly Shrinking Defense Industry*, POGO (Aug. 1, 2019), https://www.pogo.org/analysis/2019/08/the-incredibly-shrinking-defense-industry/.

[13] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-19-336SP, WEAPON SYSTEMS ANNUAL ASSESSMENT: LIMITED USE OF KNOWLEDGE-BASED PRACTICES CONTINUES TO UNDERCUT DOD'S INVESTMENTS (2019).

[14] For orders involving products or services sold to the DoD, the Under Secretary of Defense for Acquisition and Sustainment appoints a Compliance Officer to monitor compliance with the Commission's order. The Compliance Officer is an employee of the United States government and not otherwise involved in overseeing the programs that use the products or services, or in setting the requirements for or the procurement of those products or services. The Compliance Officer has the power and authority to oversee compliance with the terms of the order. For instance, the Compliance Officer has all the necessary investigative powers, including the right to interview a company's personnel, inspect its facilities, retain third-party advisors, and require the company to provide documents, data, and other information. *See, e.g., In re Northrop Grumman*, Fed. Trade Comm'n File No. 1810005 (C-4652) (modified D&O issued Dec. 3, 2018).

[15] *See* Kwoka & Moss, *supra* note 1.

[16] The Supreme Court has recognized that the FTC is an expert body with wide latitude to design remedies. *See Jacob Siegel Co. v. Fed. Trade Comm'n*, 327 U.S. 608, 613 (1946); *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 428 (1957).

7. What rules, mechanisms, or standards does the FTC abide by or employ to determine whether a behavioral remedy has been violated or has been ineffective?

The Commission has historically relied on staff working with monitors to guard against order violations. The efficacy and resource intensity of this approach raises several concerns for me, and I am examining whether the FTC should continue this practice.

8. What actions does the FTC take if it determines that a behavioral remedy has been violated or has been ineffective? Please include discussion of further imposed remedies, such as fines and orders to disgorge ill-gotten profits or unwind consummated transactions.

The FTC Act authorizes the Commission to obtain civil penalties for violations of a Commission order.[17] I fully support vigorous enforcement of existing Commission orders and the pursuit of significant civil penalties for order violations. Civil penalties for order violations can be substantial,[18] with current maximum penalties of $43,792 per violation per day.[19] In addition, the Commission may seek to expand the scope or duration of orders if the company violates the original terms. For instance, the Commission may seek additional divestiture obligations for failure to abide by the original terms,[20] or it may extend the term of the order so as to continue its oversight of the company's conduct and restore competitive conditions to the affected markets.[21]

Thank you again for your vigilance in promoting fair competition, including your support for new legislation to ensure that the Commission has the resources and tools it needs to protect the public from unlawful business practices. If you have any questions, please feel free to have your staff call Jeanne Bumpus, the Director of our Office of Congressional Relations, at (202) 326-2195.

Sincerely,

Lina Khan

Lina M. Khan
Chair

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[17] 15 U.S.C. §§ 45(l) and 56 (a)(l) as amended.

[18] FTC Press Release, FTC Imposes $5 Billion Penalty and Sweeping New Privacy Restrictions on Facebook (Jul. 24, 2019), https://www.ftc.gov/news-events/press-releases/2019/07/ftc-imposes-5-billion-penalty-sweeping-new-privacy-restrictions.

[19] *See* Press Release, FTC Publishes Inflation-Adjusted Civil Penalty Amounts for 2021 (Jan. 11, 2021), https://www.ftc.gov/news-events/press-releases/2021/01/ftc-publishes-inflation-adjusted-civil-penalty-amounts-2021.

[20] *FTC v. Schnucks Markets, Inc*., Civ. No. 01830 (E.D. Mo., Sept. 5, 1997) (supermarket chain required to pay civil penalties and divest two additional stores for failure to divest original set of stores).

[21] FTC Press Release, FTC Adds Requirements to 2014 Order to Remedy CoreLogic's Compliance Deficiencies (Mar. 15, 2018), https://www.ftc.gov/news-events/press-releases/2018/03/ftc-adds-requirements-2014-order-remedy-corelogic-incs-compliance.