



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Competition
Mergers I

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July 6, 2006

Douglas P. Larsen, Esquire
Deputy General Counsel (Acquisition & Logistics)
Department of Defense Office of General Counsel
1600 Defense Pentagon
Washington, DC 20301-1600

Re: Proposed Joint Venture Between The Boeing Company and Lockheed Martin Corporation (United Launch Alliance), File No. 051-0165

Dear Doug:

As you know, the Federal Trade Commission staff has been investigating the above-captioned transaction since May 2005, in order to determine whether the transaction is likely to violate the federal antitrust laws. The proposed joint venture would consolidate manufacturing and development of Boeing's and Lockheed's expendable launch vehicles, as well as the sale of associated launch services to the United States. Throughout our investigation we have been in close contact with your office and have benefitted from the input of the Department of Defense as the U.S. government's primary purchaser of launch services.

Based on the structure of the deal and evidence gathered in our investigation, it appears that the proposed joint venture is likely to have a substantial adverse effect on competition in the market for U.S. government intermediate and heavy launch services. The anticipated result of this anticompetitive consolidation would be to reduce the rate of innovation and other non-price benefits and increase the prices that the government, including the Air Force, NASA and other government agencies, would pay for these services. For this reason, absent countervailing public interest considerations, the proposed joint venture likely would violate Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act if consummated.

Staff's analysis follows the analytical framework set out in the *Horizontal Merger Guidelines*.¹ The starting point for that analysis is the definition of the relevant product and geographic markets at issue. Here, that analysis is relatively straightforward: based on evidence gathered in our investigation, including information provided by DOD officials, intermediate and heavy launch services constitute a relevant product market in which to assess the likely competitive effects of the proposed joint venture. That is, there are no other technologies available, either now or in the foreseeable future, that could be used to deliver the government's heaviest space vehicles into an earth orbit or beyond into outer space. The relevant geographic market is the United States, given that proscriptions of federal law and national security imperatives require the U.S. government to purchase intermediate and heavy launch services from domestic companies.

The next area of inquiry is to determine whether the markets at issue are susceptible to new entry that would alleviate any anticompetitive effects resulting from the transaction. The *Guidelines* counsel that potential competitive concerns associated with a transaction are alleviated where new entry is likely to have a significant market impact within a two-year time frame. That is not the case in the U.S. intermediate and heavy launch services market, where entry barriers are extremely high. The design and development alone of launch vehicles take many years and costs in excess of a billion dollars. Even if a firm, such as SpaceX, does attempt to enter these markets, significant market impact is likely to take even longer given the importance that government customers place on reliability. Government space vehicles cost approximately \$1 billion each and take approximately five years to produce, making construction of back-up space vehicles cost-prohibitive. As a result, the costs of a launch failure are extremely high in terms of dollars and delays in vital national security or scientific services. For these reasons, the United States only procures intermediate and heavy launch services from firms with an established track record for success.

There are only two suppliers of intermediate and heavy launch services for government customers: Lockheed and Boeing. Where, as here, there are no alternative products and there is little likelihood of significant new entry, a consolidation of the only two market participants would create a durable monopoly. In such a situation, there is a high likelihood of anticompetitive effects. In many cases, that would be the end of the antitrust inquiry. In the instant case, however, a thorough analysis must take into account the effect of U.S. Space Transportation Policy that mandates that the Department of Defense maintain an "assured access to space." We understand that assured access to space is a vital component of U.S. national security policy and requires that the Department of Defense maintain two separate families of intermediate and heavy launch vehicles to provide redundant launch capability in the event that one launch vehicle family experiences a failure. To ensure the continued availability of Boeing's Delta IV and Lockheed's Atlas V, the Department of Defense planned to non-competitively

¹ Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, issued April 2, 1992, *revised* April 8, 1997.

allocate launches between Boeing and Lockheed under a cost-plus contracting scheme known as Buy 3. As such, a question has been raised regarding the extent to which Boeing and Lockheed are likely to compete in the future. Additionally, under Buy 3, Boeing and Lockheed would have received annual infrastructure subsidies totaling nearly \$550 million. The parties have claimed that the proposed transaction may save the United States approximately \$150 million annually in infrastructure costs, which they contend would reduce the subsidy costs to the government. In antitrust analysis, savings are relevant because in some cases, efficiency gains associated with a transaction may ameliorate the adverse impact the transaction may have on competition.

Information gathered in our investigation indicates that even under the Buy 3 contracting arrangement, the competitive interaction between the parties is likely to benefit the government. Under Buy 3, the Department of Defense would retain the ability to award more launches to one firm, at the expense of the other, and we understand that Buy 3 includes incentives for the parties to be awarded additional launches. That competitive interaction likely would produce significant non-price benefits in the areas of reliability, responsiveness, and design innovation. Moreover, Buy 3 is scheduled to end in 2011. If Buy 3 is not renewed or replaced with a similar arrangement, the government would then have an opportunity to negotiate in a competitive environment for future launch services. Finally, it appears that current U.S. Space Transportation Policy contemplates the possibility that at some point in the future assured access to space may not require two separate families of launch vehicles. The creation of the joint venture would eliminate the possibility of conducting a competitive down select to either the Delta or Atlas vehicle if such a policy determination were made.

The proposed transaction also raises vertical issues. Boeing and Lockheed are two of only three competitors – the third being Northrop Grumman – in the government satellite market. Today, competition between Boeing and Lockheed for launch services may impact the companies' willingness to cooperate with Northrop. After Boeing and Lockheed merge their launch vehicle businesses, however, there may be no competitive incentive to optimize their launch vehicles for use with Northrop satellites. Further, as vertically integrated suppliers, Boeing and Lockheed likely would have incentives to share confidential Northrop information obtained as a launch vehicle services supplier with their respective satellite businesses, thereby adversely affecting the government satellite market. While the ability to share such information is limited by the Commission's order in *In the Matter of the Boeing Company* (Docket No. C-3992), it is possible that the exchange of information that is not prohibited under that order may occur after the merger.

Considering the likely anticompetitive consequences of the proposed transaction, the efficiency benefits to the customer would have to be unusually credible and significant in order to determine that the transaction is not anticompetitive on balance. Indeed, the *Guidelines* instruct that potential cost savings are unlikely ever to justify the creation of a monopoly, as consumers are unlikely to realize the benefits of those cost savings in the absence of competition. Here, our understanding is that the Department of Defense has concluded that the proposed transaction may yield substantial cost savings (though perhaps less than the parties have predicted). Even

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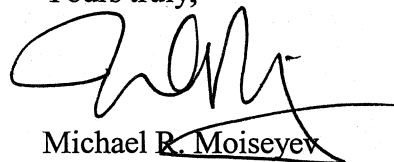
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assuming that savings ultimately are generated, it is unlikely that a significant portion of the savings would be passed on to government customers in the absence of competitive incentives to do so, notwithstanding the auditing and sole source procurement authority that the Department of Defense has at its disposal. In light of the significant anticompetitive potential of the proposed transaction and the fact that the government is unlikely to benefit from much of the cost savings that may be generated by the transaction, we are unable to conclude that the cost savings are sufficient to reverse the transaction's potential to harm the government.

In short, the joint venture unambiguously will create a monopoly in the market for medium and heavy launch services for the U.S. government. Monopolies almost always lead to higher prices, lower quality and inferior service. Here, the competition that would be lost is significant, and the economic benefits that may materialize are unlikely to trump the transaction's harm to competition. That being said, we are mindful of the fact that the transaction may produce non-economic benefits that could further the missions of the Department of Defense and other government customers. Indeed, we understand from our discussions that the Department of Defense has identified potential benefits of this type, including increased launch reliability. Those benefits, to the extent they are present in the proposed joint venture, clearly would impact the decision of whether the transaction is in the public interest.

Thank you again for your cooperation and assistance with our investigation. I look forward to continuing our dialog with you and your colleagues regarding the transaction. Please feel free to contact me should you have any questions regarding this matter.

Yours truly,



Michael R. Moiseyev
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