

ANALYSIS OF AGREEMENT CONTAINING CONSENT ORDERS TO AID PUBLIC COMMENT

In the Matter of General Dynamics Corporation

File No. 061-0150, Docket No. C-4181

I. Introduction

The Federal Trade Commission (“Commission”) has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from General Dynamics Corporation (“GD”). The purpose of the proposed Consent Agreement is to remedy the competitive harm that would otherwise result from GD’s acquisition of SNC Technologies, Inc. and SNC Technologies, Corp. (collectively “SNC”). Under the terms of the proposed Consent Agreement, GD is required to divest its interest in American Ordnance LLC to a buyer approved by the Commission in a manner approved by the Commission within four months of acquiring SNC.

The proposed Consent Agreement has been placed on the public record for thirty days to solicit comments from interested persons. Comments received during this period will become part of the public record. After thirty days, the Commission will again review the proposed Consent Agreement and the comments received, and will decide whether it should withdraw the proposed Consent Agreement or make it final.

On February 23, 2006, GD entered into a Share Purchase Agreement to acquire SNC from SNC-Lavalin Group for approximately \$275 million (CAN\$315 million). The Commission’s complaint alleges that the proposed acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by bringing together two of only three competitors in the market for melt-pour load, assemble and pack services (“LAP services”) for mortar rounds and artillery shells in the United States and Canada. The proposed Consent Agreement would remedy the alleged violations by requiring a divestiture that will replace the competition that otherwise would be lost in this market as a result of the acquisition.

II. The Parties

GD is a diversified defense company with leading market positions in aviation, information systems, shipbuilding and marine systems, and land and amphibious combat systems. General Dynamics Ordnance and Tactical Systems (“GD-OTS”) is a business unit within GD that manufactures large and medium caliber ammunition and precision metal components, produces spherical propellant for small caliber ammunition used in various military applications, provides explosive LAP services for a variety of tactical missile and rocket programs, and designs and produces shaped charge warheads and control actuator systems. GD-OTS also maintains a fifty percent interest in American Ordnance, a joint venture with Day & Zimmerman, Inc. (“DZI”) formed to operate the Middletown, Iowa Army ammunition plant (“Iowa AAP”) and Milan, Tennessee Army ammunition plant (“Milan AAP”) under a single entity to gain certain economic efficiencies. In 2005, GD had revenues of over \$21.2 billion, and

GD-OTS sold approximately \$615 million in munitions and propellant.

SNC develops and manufactures ammunition and ammunition systems for Canadian and United States military divisions and law enforcement agencies. The company's products include large, medium, and small caliber ammunition, propellants, propelling charges and explosives, pyrotechnics, and simulated ammunition products for training applications. It also provides a wide variety of LAP services, including melt-pour. In 2005, SNC garnered approximately \$286 million in sales, including \$136 million from sales within the United States.

III. The Relevant Product Market

The relevant product market in which to evaluate the proposed acquisition is the market for melt-pour LAP services for mortar rounds and artillery shells. Mortar rounds and artillery shells are relatively inexpensive, mass-produced projectiles employed by infantry troops. Melt-pour LAP services are the critical final step in producing and delivering mortar rounds and artillery shells to the U.S. military. LAP services consist of filling (or loading) the mortar with an explosive, trinitrotoluene ("TNT"), assembling the various components to complete the munition and packing the rounds for safe shipment to various military installations around the world. LAP services other than melt-pour or using different explosives than TNT are either too expensive or cumbersome for use with mass-produced weapons such as mortar rounds and artillery shells. As a result, a five to ten percent increase in the cost of melt-pour LAP services for mortar rounds and artillery shells would not cause the U.S. military to switch to any other type of LAP services.

The U.S. military contracts with suppliers for its requirements of melt-pour LAP services for mortar rounds and artillery shells. Contracts for melt-pour LAP services for mortar rounds and artillery shells typically are bid out every five years – one-year firm contract with four one-year renewal options. The Army is currently in the process of awarding two contracts for LAP services – a combined 60 mm and 81 mm mortar contract and a 120 mm mortar contract. The next melt-pour LAP services contracts for mortar rounds and artillery shells will not likely be competed until 2011.

IV. Market Structure & Participants

The market for melt-pour LAP services for mortar rounds and artillery shells is highly concentrated. At present, only three companies have the ability to effectively supply these services to the United States Army: SNC, American Ordnance, and DZI. Each of these companies currently contracts with the Army to provide at least one type mortar round or artillery shell melt-pour LAP service. SNC's melt-pour operations are located in its privately-owned facility in Le Gardeur, Canada. American Ordnance and DZI both operate melt-pour facilities that are parts of Army ammunition plants ("AAPs") owned by the U.S. government and run by private companies. American Ordnance operates two such plants, the Milan AAP and the Iowa AAP. DZI currently operates the AAP located in Parsons, Kansas ("Kansas AAP").

Through its plant in Le Gardeur, Canada, SNC produces large, medium, and small caliber ammunition ranging from 155 mm artillery shells to small caliber bullets. The company currently provides various caliber mortar rounds and artillery shells for the Canadian government, as well as 120 mm mortar rounds for the U.S. military. In 2005, SNC's Le Gardeur plant produced sales revenues of approximately \$45 million in propellant, explosives and ammunition.

American Ordnance is a joint venture owned equally by GD and DZI. The companies share equally in the profits of the joint venture, and both have representatives on American Ordnance's board of directors. American Ordnance, however, has its own management structure, and neither GD nor DZI is involved in the day-to-day operations of the joint venture. American Ordnance has contracts with the U.S. government to operate the Iowa and Milan AAPs through December 31, 2008. The Army has recently begun the process of seeking proposals for contracts to operate those plants after that date and anticipates awarding the contracts by September of 2008, at the latest, to provide sufficient transition time if a company other than American Ordnance wins the contracts.

In addition to its fifty percent ownership interest in American Ordnance, DZI also operates the Kansas AAP. Future operations of the Kansas AAP are doubtful, however, as the plant was designated for closure as part of the 2005 Base Realignment and Closure ("BRAC") legislation. The BRAC recommendations call for operations located at the Kansas AAP to be moved to other plants beginning in 2008, with full closure of the Kansas AAP scheduled to take place by 2011. Therefore, although three market participants existed in the most recent round of contracting for the provision of melt-pour LAP services for mortar rounds and artillery shells, it appears unlikely that the Kansas facility will remain a viable alternative for the next round of contracting, leaving only SNC and American Ordnance to bid.

V. Competitive Effects

The proposed transaction raises competitive concerns in the market for melt-pour LAP services for mortar rounds and artillery shells because, post-transaction, GD would own 100% of SNC, while at the same time retaining fifty percent ownership in American Ordnance. The competitive concerns arising from GD having some level of ownership interest in two of the three companies currently in the market for melt-pour LAP services for mortar rounds and artillery shells are compounded by the fact that DZI appears likely to lose access to the Kansas AAP and, thus, may be unable to compete for the next round of contracts. This raises the likelihood that GD could act unilaterally to raise prices or otherwise engage in anticompetitive behavior in the market for melt-pour LAP services for mortar rounds and artillery shells. The proposed transaction also raises competitive concerns relating to the current round of competition for melt-pour LAP services for 120 mm and 60 mm and 81 mm mortar rounds.

Absent Commission action, it appears likely that the only two potential bidders for current and future melt-pour LAP service contracts for mortar rounds or artillery shells are SNC

and American Ordnance. With the proposed acquisition, GD has an incentive to act unilaterally to raise prices in the relevant product market because it will own all of SNC and receive half of the profits from American Ordnance. GD would have an incentive to submit bids with higher pricing, or other less competitive terms, than SNC would have submitted as an independent company because even if GD/SNC loses the bid, it would lose to American Ordnance, in which GD shares fifty percent of the profits. Therefore, GD would have less incentive to compete vigorously for these contracts, because it would benefit financially regardless of which company wins the contract.

The proposed transaction also increases the likelihood that GD and American Ordnance could coordinate their competing bids for contracts. Through its ownership in American Ordnance, GD would have certain contacts and access to competitively sensitive information that could facilitate reaching terms of coordination, and the detection and punishment of deviations from those terms.

VI. Entry Conditions

Entry into the market for the provision of melt-pour LAP services for mortar rounds and artillery shells appears unlikely to occur within the relevant time frame. Establishing a melt-pour operation to effectively enter and compete in this market is expensive and time-consuming, and is unlikely to occur in the next two years, particularly because the Army is not planning any new acquisitions before 2011. Further, even if a firm were to enter the market, it would face the difficult task of winning a bid for a critical product without a demonstrated track record of being able to produce and deliver the product.

VII. The Proposed Consent Agreement

The proposed Consent Agreement effectively remedies the competitive harm that would likely result from the acquisition by requiring GD to divest its interest in American Ordnance, at no minimum price, to a purchaser that receives the prior approval of the Commission and in a manner that receives the prior approval of the Commission. The proposed Consent Agreement requires GD to divest its interest in American Ordnance within four months after it completes its acquisition of SNC. By requiring the divestiture of General Dynamic's interest in American Ordnance to a third party, the proposed Consent Agreement ensures that American Ordnance and a combined GD/SNC will remain independent competitors in the market post-acquisition.

Because the Consent Agreement contemplates a divestiture by GD of its interest in American Ordnance after acquiring SNC, an order to hold the American Ordnance business separate ("Hold Separate Order") is included. The Hold Separate Order requires that GD keep the American Ordnance business separate and apart from its other GD businesses, and that the company refrain from involvement in the direction, oversight, or influence of American Ordnance's business. The Hold Separate Order also requires that GD's members of American Ordnance's board of managers be replaced with independent managers who are not affiliated

with GD in any way. GD may not permit any of its employees, officers, or directors to be involved in the operations of American Ordnance while the Hold Separate Order remains in effect.

The proposed Consent Agreement also allows the Commission to appoint an interim monitor to oversee GD's compliance with all of its obligations and performance of its responsibilities pursuant to the Commission's Decision and Order. The interim monitor, if appointed, would be required to file periodic reports with the Commission to ensure that the Commission remains informed about the status of the divestiture and the efforts being made to accomplish the divestiture.

The proposed Consent Agreement includes a provision that requires GD to notify the Commission within five days of submitting a proposal to obtain the facilities use contract for either the Iowa AAP or the Milan AAP, and to provide the Commission with copies of all documents submitted as part of the proposal. This notification will allow the Commission to consult with the Department of Defense and the Army regarding possible competitive concerns that may arise in the future should GD be awarded the contracts to operate these melt-pour facilities in addition to owning SNC.

The purpose of this analysis is to facilitate public comment on the Consent Agreement, and it is not intended to constitute an official interpretation of the Consent Agreement or to modify its terms in any way.