UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,
Department of Justice
Antitrust Division
1401 H Street, N.W., Suite 3000
Washington, DC 20530,

Plaintiff,

v.

LEHMAN BROTHERS HOLDINGS INC.
3 World Financial Center
New York, NY 10285,

and

L-3 COMMUNICATIONS HOLDINGS, INC.
600 Third Avenue
New York, NY 10016

Defendants.

Civil No.: 1:98CV00796 (SS)

Filed: April 1, 1998

COMPETITIVE IMPACT STATEMENT

The United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I. NATURE AND PURPOSE OF THE PROCEEDING

On March 27, 1998, the United States filed a civil antitrust Complaint alleging that the proposed acquisition by L-3 Communications Corporation ("L-3 Communications"), a wholly

owned subsidiary of L-3 Communications Holdings, Inc., of the AlliedSignal Ocean Systems business unit ("Ocean Systems"), a wholly owned business unit of AlliedSignal Inc. ("AlliedSignal"), and AlliedSignal ELAC Nautik GmbH ("ELAC"), a wholly owned subsidiary of AlliedSignal Deutschland GmbH, which is a wholly owned subsidiary of AlliedSignal, would violate Section 7 of the Clayton Act, 15 U.S.C. § 18.

The Complaint alleges that the acquisition would violate Section 7 of the Clayton Act because Lockheed Martin Corporation ("Lockheed Martin") owns 34.0% of the common stock of L-3 Communications and controls three of ten seats on the L-3 Communications Board of Directors, and Lockheed Martin and Ocean Systems are the two leading competitors in the design, development, manufacture and sale of towed sonar arrays ("towed arrays") to the U.S. Department of Defense ("DoD"). If L-3 Communications were to acquire Ocean Systems, L-3 Communications and Lockheed Martin would become competitors. Towed arrays are sonar systems consisting of very long hose-like structures that are towed behind surface ships and submarines for the purpose of detecting submarines or torpedoes, depending on the type of array. The arrays are linked to electronic signal processing equipment on board the ship or submarine towing the array. This equipment processes the sounds picked-up by the arrays to determine the source of the sound.

As described in the Complaint, since towed arrays are sold to DoD and there are no foreign producers to which DoD or its U.S. prime contractors could reasonably turn to purchase these arrays, the relevant geographic market is the United States.

The prayer for relief in the Complaint seeks: (1) a judgment that the proposed acquisition would violate Section 7 of the Clayton Act; and (2) a permanent injunction preventing

L-3 Communications from acquiring Ocean Systems and ELAC.

When the Complaint was filed, the United States also filed a proposed settlement that would permit L-3 Communications to complete its acquisition of Ocean Systems and ELAC, and preserve competition in the relevant market, by requiring L-3 Communications to establish and maintain a "firewall" whereby it would refrain from discussing with or disclosing to any employee, officer or director of Lockheed Martin, or person nominated by Lockheed Martin, who is also a member of the Board of Directors of, or an officer of, L-3 Communications any non-public information relating to the Ocean Systems and ELAC businesses. The firewall also requires that these same individuals not share with L-3 Communications any non-public information of Lockheed Martin relating to Lockheed Martin's sonar and mine warfare products. Additionally, the settlement prohibits L-3 Communications from entering into joint bidding or teaming agreements with Lockheed Martin for the purpose of bidding on DoD contracts for towed arrays. The settlement does not, however, bar L-3 Communications from entering into a contract or subcontract with Lockheed Martin which relates to towed arrays, after DoD has awarded a contract. The settlement is embodied in a Stipulation and Order and a proposed Final Judgment.

The proposed Final Judgment requires L-3 Communications to implement the firewall and begin abiding by the prohibitions on entering into joint bidding or teaming agreements with Lockheed Martin for DoD contracts for towed arrays immediately upon the filing of the proposed Final Judgment and the Complaint in this matter. L-3 Communications must maintain the firewall and abide by the prohibitions on certain joint bidding and teaming agreements for the duration of the proposed Final Judgment. The proposed Final Judgment continues in force until

such time as Lockheed Martin owns less than five percent of the voting securities of L-3 Communications and there are no employees, officers or directors of Lockheed Martin, or persons nominated by Lockheed Martin, on the L-3 Communications Board of Directors. L-3 Communications must certify to DOJ sixty (60) calendar days after the filing of the Complaint in this matter and annually thereafter the steps it has taken to comply with the provisions set forth in the proposed Final Judgment.

The terms of the Stipulation and Order entered into by the parties apply to ensure that the Ocean Systems and ELAC businesses to be acquired by L-3 Communications shall be maintained as independent competitors of Lockheed Martin.

The plaintiff and defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate the action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment and to punish violations thereof.

II. DESCRIPTION OF THE EVENTS GIVING RISE TO THE ALLEGED VIOLATION

A. The Defendants and the Proposed Transaction

Lehman Brothers Holdings Inc. is a Delaware corporation headquartered in New York, New York. Its business activities are in financial services and merchant and investment banking. In 1997, Lehman Brothers Holdings Inc. had net revenues of $3.8 billion.

L-3 Communications Holdings, Inc. is a Delaware corporation headquartered in New York, New York. L-3 Communications is a leading provider of sophisticated secure communication systems and specialized communication products including high data-rate communications systems, microwave components, avionics, and telemetry and instrumentation

products. In 1997, L-3 Communications had sales of approximately $700 million.

On December 22, 1997, L-3 Communications and AlliedSignal entered into a Purchase Agreement, whereby L-3 Communications would acquire from AlliedSignal its Ocean Systems and ELAC businesses. This transaction, which would give Lockheed Martin, through its ownership interest in L-3 Communications, influence over, and access to non-public information of, the other leading competitor in the design, development, manufacture and sale of towed arrays to DoD, precipitated the government's suit.

B. Towed Arrays Market

Towed arrays are sonar systems designed to be towed by a submarine or a surface vessel. Towed arrays deployed by submarines are designed to detect other submarines. The arrays are long, hose-like structures measuring up to a thousand feet or longer that contain specially designed acoustic sensors, called hydrophones, which pick up sound. The arrays include electronics that convert the acoustical waves from analog to digital form and transmit that data to electronic processors on board the submarine. Processing the data involves such functions as distinguishing the sounds generated by submarines from the sounds made by other sources, such as whales. The construction of the hose-like structure containing the hydrophones and electronics requires specialized skills which few companies possess. Towed arrays deployed by submarines must be designed to withstand the extreme environmental stresses of operation in the ocean depths.

Towed arrays deployed by surface combat vessels are designed to detect submarines and torpedoes. They have different mechanisms for deploying, reeling in and storing the arrays and face different environmental stresses than those deployed by submarines. Towed arrays used by

surface combat vessels are towed at much greater speed than those towed by submarines or non-combat ships and require engineering solutions to deal with the "noise" generated by dragging the array through the water. Towed arrays deployed by non-combat surface ships are designed to detect submarines, but not torpedoes. Only about ten percent of towed arrays for surface ships are those designed for non-combat ships.

There are no substitutes for towed arrays and therefore no other products to which DoD or U.S. prime contractors could turn in the face of a small but significant and non-transitory price increase by suppliers of towed arrays.

C. Harm to Competition As A Consequence of the Acquisition

Ocean Systems and Lockheed Martin are the two leading firms in the design and production of towed arrays. Over ninety percent of the towed arrays deployed by submarines have been designed and built by Lockheed Martin and Ocean Systems. Over eighty percent of the towed arrays deployed by surface combat ships were built by Ocean Systems and Lockheed Martin (and companies it acquired). The other company that previously built towed arrays for surface combat ships has not won a DoD contract for towed arrays in over a decade. Because of their prior experience and repeated success in winning DoD towed array contracts, Lockheed Martin and Ocean Systems are likely to be the primary providers of towed arrays purchased by DoD in the future.

In 1998, DoD is expected to conduct a competition, known as the Omnibus Competition, for the next generation of towed arrays to be deployed by submarines and surface combat and non-combat vessels. The award of this contract is expected to cover both design and production. This contract will likely be awarded on the basis of "best value" which considers a bidder's price

and the quality of its technical proposal. The evaluation of the technical proposal generally includes an assessment of the riskiness of the proposal and the bidder's prior experience. Given their long history in designing and producing towed arrays for DoD, Ocean Systems and Lockheed Martin likely will be the leading contenders for the Omnibus contract, as well as for any future DoD towed array contracts. Other potential competitors do not have the experience of these two companies in the design and production of towed arrays.

L-3 Communications' acquisition of Ocean Systems is likely significantly to lessen competition for towed array contracts awarded by DoD. Because Lockheed Martin sits on the Board of Directors of L-3 Communications, the acquisition could result in the two leading providers of towed arrays to DoD having access to each other's business plans, costs, pricing data and decisions, and other internal and competitively sensitive information. The exchange of such information could significantly decrease the willingness and ability of L-3 Communications and Lockheed Martin to engage in vigorous competition for DoD contracts for towed arrays. Access to information revealing each other's costs, pricing and technical efforts would provide them with information that could decrease their incentive to bid aggressively on DoD contracts and therefore could lead to higher prices paid by DoD. Access to such information could also decrease their incentive to minimize costs or to innovate in the design or manufacture of towed arrays.

Successful entry into the production and sale of towed arrays is difficult, and costly. Entry requires advanced technology, skilled engineers, specialized know-how and costly customized equipment and facilities. A potential entrant would have to engage in difficult, expensive, and time consuming research to develop designs and production processes that can

economically and reliably produce towed arrays. These designs and production processes must be perfected before an entrant can successfully bid for a DoD towed array contract. It is unrealistic to expect new entry in a timely fashion to protect competition in upcoming DoD towed array competitions.

The Armed Forces of the United States rely on the ongoing, vigorous competition between Ocean Systems and Lockheed Martin for the development and production of towed arrays. The proposed acquisition will lessen this competition, and will result in an increase in prices paid by the United States and a decrease in innovation for towed arrays and will, therefore, violate Section 7 of the Clayton Act.

The Complaint alleges that the transaction would have the following effects, among others: competition generally in the innovation, development, production and sale of towed arrays for military purposes in the United States would be lessened substantially; actual and future competition between Ocean Systems and Lockheed Martin in the innovation, development, production and sale of towed arrays for military purposes in the United States would be lessened substantially; and prices for towed arrays for military purposes in the United States would likely increase.

III. EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The provisions of the proposed Final Judgment are designed to eliminate the anticompetitive effects of the acquisition of Ocean Systems by L-3 Communications.

The proposed Final Judgment requires L-3 Communications to implement a firewall immediately upon the filing of the Complaint in this matter and to certify within sixty (60) calendar days after the filing of the Complaint that it has implemented the firewall provisions set

forth in the proposed Final Judgment. The firewall provisions require that L-3 Communications shall not discuss, provide, disclose or otherwise make available, directly or indirectly, any non-public information relating to the Ocean Systems and ELAC businesses, to (1) any employee, officer or director of Lockheed Martin, who is also a member of the Board of Directors of, or an officer of, L-3 Communications, or (2) any member of the Board of Directors of L-3 Communications nominated by Lockheed Martin. Additionally, L-3 Communications must require that any member of the Board of Directors of L-3 Communications who was either nominated by Lockheed Martin or who is an employee, officer or director of Lockheed Martin refrain from discussing, providing, disclosing or otherwise making available, directly or indirectly, any non-public information of Lockheed Martin relating to its sonar or mine warfare products. The firewall provisions also require that L-3 Communications shall conduct all business relating to Ocean Systems and ELAC without the vote, concurrence, attendance or other participation of any individuals serving on the L-3 Communications Board of Directors who is an employee, officer or director of Lockheed Martin or who was nominated by Lockheed Martin. Finally, the proposed Final Judgment prohibits L-3 Communication from entering into joint bidding or teaming agreements with Lockheed Martin for the purpose of bidding on DoD contracts for towed arrays. This prohibition does not bar L-3 Communications from entering into a contract or subcontract with Lockheed Martin after DoD has awarded a towed array contract.

The provisions of the Final Judgment preserve competition because they will ensure that any business decisions made by L-3 Communications concerning the Ocean Systems and ELAC businesses it is acquiring from AlliedSignal will be made without sharing any non-public information with Lockheed Martin or receiving any non-public information from Lockheed

Martin and because L-3 Communications and Lockheed Martin will be required to compete separately for DoD towed array contracts.

IV. REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act (15 U.S.C. § 15) provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act (15 U.S.C. § 16(a)), the proposed Final Judgment has no prima facie effect in any subsequent private lawsuit that may be brought against defendants.

V. PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The APPA provides a period of at least 60 days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within sixty (60) days of the date of publication of this Competitive Impact Statement in the Federal Register. The United States will evaluate and respond to the comments. All comments will be given due consideration by the Department of Justice, which remains free to

withdraw its consent to the proposed Judgment at any time prior to entry. The comments and the response of the United States will be filed with the Court and published in the Federal Register. Written comments should be submitted to:

J. Robert Kramer II
Chief, Litigation II Section
Antitrust Division
United States Department of Justice
1401 H Street, NW, Suite 3000
Washington, D.C. 20530

The proposed Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgment.

VI. ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

The United States considered, as an alternative to the proposed Final Judgment, a full trial on the merits against defendants Lehman Brothers Holdings Inc. and L-3 Communications Holdings, Inc. The United States could have brought suit and sought preliminary and permanent injunctions against L-3 Communications' acquisition.

The United States is satisfied that the provisions set forth in the proposed Final Judgment will encourage viable competition in the research, development, and production of towed arrays. The United States is satisfied that the proposed relief will prevent the acquisition from having anticompetitive effects in this market. The provisions of the Final Judgment will restore the towed array market to the competitive conditions that existed prior to the acquisition.

VII. STANDARD OF REVIEW UNDER THE APPA FOR PROPOSED FINAL JUDGMENT

The APPA requires that proposed consent judgments in antitrust cases brought by the

United States be subject to a sixty-day comment period, after which the court shall determine whether entry of the proposed Final Judgment "is in the public interest." In making that determination, the court may consider --

> (1) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or relief sought, anticipated effects of alternative remedies actually considered, and any other considerations bearing upon the adequacy of such judgment;
>
> (2) the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e) (emphasis added). As the Court of Appeals for the District of Columbia Circuit recently held, the APPA permits a court to consider, among other things, the relationship between the remedy secured and the specific allegations set forth in the government's complaint, whether the decree is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. See United States v. Microsoft, 56 F.3d 1448 (D.C. Cir. 1995).

In conducting this inquiry, "the Court is nowhere compelled to go to trial or to engage in extended proceedings which might have the effect of vitiating the benefits of prompt and less costly settlement through the consent decree process."[1/] Rather,

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[1] 119 Cong. Rec. 24598 (1973). See also United States v. Gillette Co., 406 F. Supp. 713, 715 (D. Mass. 1975). A "public interest" determination can be made properly on the basis of the Competitive Impact Statement and Response to Comments filed pursuant to the APPA. Although the APPA authorizes the use of additional procedures, 15 U.S.C. § 16(f), those procedures are discretionary. A court need not invoke any of them unless it believes that the comments have raised significant issues and that further proceedings would aid the court in resolving those issues. See H.R. 93-1463, 93rd Cong. 2d Sess. 8-9, reprinted in (1974) U.S. Code Cong. & Ad. News 6535, 6538.

> absent a showing of corrupt failure of the government to discharge its duty, the Court, in making its public interest finding, should . . . carefully consider the explanations of the government in the competitive impact statement and its responses to comments in order to determine whether those explanations are reasonable under the circumstances.

United States v. Mid-America Dairymen, Inc., 1977-1 Trade Cas. ¶ 61,508, at 71,980 (W.D. Mo. 1977).

Accordingly, with respect to the adequacy of the relief secured by the decree, a court may not "engage in an unrestricted evaluation of what relief would best serve the public." United States v. BNS, Inc., 858 F.2d 456, 462 (9th Cir. 1988), quoting United States v. Bechtel Corp., 648 F.2d 660, 666 (9th Cir.), cert. denied, 454 U.S. 1083 (1981); see also, Microsoft, 56 F.3d 1448 (D.C. Cir.1995). Precedent requires that

> [t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is 'within the reaches of the public interest.' More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.[2]

The proposed Final Judgment, therefore, should not be reviewed under a standard of whether it is certain to eliminate every anticompetitive effect of a particular practice or whether it mandates certainty of free competition in the future. Court approval of a final judgment requires a standard more flexible and less strict than the standard required for a finding of liability. "[A] proposed decree must be approved even if it falls short of the remedy the court would impose on

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[2] United States v. Bechtel, 648 F.2d at 666 (internal citations omitted)(emphasis added); see United States v. BNS, Inc., 858 F.2d at 463; United States v. National Broadcasting Co., 449 F. Supp. 1127, 1143 (C.D. Cal. 1978); United States v. Gillette Co., 406 F. Supp. at 716. See also United States v. American Cyanamid Co., 719 F.2d 558, 565 (2d Cir. 1983).

its own, as long as it falls within the range of acceptability or is 'within the reaches of public interest.' (citations omitted)."[3/]

VIII. DETERMINATIVE DOCUMENTS

There are no determinative materials or documents within the meaning of the APPA that were considered by the United States in formulating the proposed Final Judgment.

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[3] United States v. American Tel. and Tel Co., 552 F. Supp. 131, 150 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983), quoting United States v. Gillette Co., supra, 406 F. Supp. at 716; United States v. Alcan Aluminum, Ltd., 605 F. Supp. 619, 622 (W.D. Ky 1985).

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Dated: March 31, 1998

CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury that on this 1st day of April, 1998, I caused copies of the foregoing COMPETITIVE IMPACT STATEMENT to be served by first-class mail, postage prepaid, upon the following:

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