

Congress of the United States
House of Representatives
Washington, DC 20515-0517

March 20, 2017

Mr. Glenn Fine
Acting Inspector General
U.S. Department of Defense
Office of Inspector General
4800 Mark Center Drive
Alexandria, VA 22350-1500

Dear Mr. Fine:

I write to request that your office open an investigation into TransDigm Group for potential waste, fraud, and abuse in the defense industrial base. As a member of the House Committee on Armed Services, I am particularly interested in and have been carefully monitoring reports related to defense procurement. Such reports suggest that TransDigm Group has been operating as a hidden monopolist by (i) engaging in a series of unreasonable price increases of products for which it is the only supplier, (ii) disguising its cost structure and identity from Pentagon procurement officers, and (iii) unreasonably hiking prices to benefit shareholders and executives.¹

By way of background, TransDigm Group is a specialized developer, distributor, and manufacturer of commercial and military aerospace components. TransDigm does not appear to develop products itself; rather, it is a holding company specializing in the identification and acquisition of manufacturers of rarely noticed "proprietary" aerospace parts. Once a manufacturer is acquired, TransDigm quickly moves to raise prices for the product. According to its 2016 annual report, TransDigm's operating margins exceed 40 percent and "80 percent of our sales come from products for which we believe we are the sole source provider." Its Chief Executive Officer, W. Nicholas Howley, was paid \$18.7 million in total compensation in 2016.²

Below is a chart detailing the price for five aerospace parts before TransDigm acquired the parts manufacturer and the price for the same parts after TransDigm acquired the manufacturer:

¹ <http://createsend.com/tj-B97DE270A031AE3D>; <http://createsend.com/tj-7370E8A3EE87FB03>

² <http://www.reuters.com/article/idUSFWN1FA0IJ>

Company	Part	Pre-Acquisition Price	Post-Acquisition Price
Aerosonic	Vibration Panel	\$67.33	\$271.00
Arkwin	Pawl	\$972.00	\$1950.00
Harco	Cable Assembly	\$1737.03	\$7863.60
Skurka	Connector	\$310.00	\$1109.82
Whippany	Motor Rotor	\$654.46	\$5474.00

Source: *The Capitol Forum*

As you are aware, federal regulations protect the taxpayer against sole source contractors like TransDigm. When a vendor is understood to be a monopoly supplier, that supplier is required to in turn offer cost information about the product to the government or otherwise the government must conduct a thorough review of the likely cost of the product. In addition, vendors must tell procurement officers if they belong to a holding company to allow the government access to transparency in pricing across a defense contractor's entire business.³

TransDigm appears to use a range of methods to evade these protections. For example, according to reports, TransDigm avoids showing that it is a monopoly provider of parts by setting up a network of captive distributors that mimic the aesthetics of a competitive market⁴ Despite the illusion of competition, distributors that provide TransDigm parts, for the most part, are buying from one TransDigm subsidiary, and that subsidiary sets its price to distributors. The procurement officer, however, sees multiple sellers of the product, without realizing that he or she is in fact buying from a monopoly. Thus, the officer does not know to ask for the cost structure. Even when competition among distributors is limited, the officer may simply ask the distributor for its cost information, rather than asking TransDigm for its cost information. In fact, your office identified exclusive distributors as problematic in a 2008 audit of Dutch Valley, which is a TransDigm distributor. You concluded in 2008: "*We do not believe the current exclusive distributor model is a viable procurement alternative for the DOD.*"⁵

Furthermore, in DOD filings known as SAM registration forms, 12 TransDigm subsidiaries failed to disclose TransDigm as their corporate parent; following publication of the inaccurate disclosure, the company has since amended its filings.⁶ The SAM form itself is clear that filing inaccurate reports – thereby making it more difficult for the Government to track spending – carries significant penalties. Upon submitting a filing, TransDigm employees read this disclosure:

By submitting this registration, you are certifying the information is accurate and complete. Knowingly providing false or misleading information may result in criminal prosecution under

³ <https://www.gpo.gov/fdsys/pkg/FR-2014-05-30/html/2014-12387.htm>

⁴ <http://createsend.com/t/j-C0FC2B87FBAC7A2B>

⁵ <http://www.dodig.mil/audit/reports/fy08/08-048.pdf>

⁶ <http://createsend.com/t/j-7370E8A3EE87FB03>; <http://createsend.com/t/j-E021310DD5FA562D>; <http://createsend.com/t/j-0D9AB56153817C00>

Section 1001, Title 18 of the United States Code. Criminal Penalties could include imposition of a fine, imprisonment, or both. You may be subject to other penalties as well, including, but not limited to, administrative remedies, such as suspension and debarment; ineligibility to participate in programs conducted under the authority of the Small Business Act; or civil liability under the False Claims Act.

With this in mind, I have the following questions.

- 1) Given that much of the activity involved in TransDigm's business operations includes obfuscating or hiding cost structures, what is the aggregate cost to the Federal government of this company's price increases on its total aerospace product portfolio? How much of this increase in cost is related to improved performance for those products? How much business does the DOD do with TransDigm, both directly through government contracts and indirectly through an original equipment manufacturer (OEM)?
- 2) While TransDigm appears to have failed to properly report its subsidiaries' corporate ownership on SAM filings for 12 of its subsidiaries; it did report the appropriate status of its subsidiaries to investors in its 10-K forms. Can you explain how procurement officers would have approached bids from TransDigm differently had this information been reported accurately? Further, what is the status of the investigation into those inaccurate filings?
- 3) What measures can DOD implement to better inform its contracting officers of TransDigm's business policy of price increases? What steps, if any, can DOD take in the short term to lower the cost of TransDigm parts?
- 4) What can Congress do to make it easier to require that monopoly aerospace and defense parts suppliers provide timely and accurate cost data to contractors?
- 5) What is the status of DOD reforms to policies that you identified in previous reports of problems with exclusive distributors and monopoly parts suppliers like TransDigm?
- 6) Who at DOD is responsible for oversight of the contracting officers that approve TransDigm contracts?

Given that the Trump administration is proposing budget increases for the military, it is incumbent upon Congress to ensure that these increases provide for the common defense, rather than enrich a few individual financiers who stand to benefit at the expense of our troops and weapons systems.

I am grateful for your attention to my request for an investigation of this matter. I look forward to hearing from you and working with you in the 115th Congress to strengthen our nation's defense and to support the brave men and women of the U.S. Armed Forces.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ro Khanna', with a long horizontal flourish extending to the right.

M.C.

Ro Khanna
Member of Congress

cc:

The Honorable Jim Mattis
Secretary of Defense
U.S. Department of Defense
1000 Defense Pentagon
Washington, DC 20301

The Honorable Congressman Mac Thornberry
Chairman, House Armed Services Committee
2208 Rayburn House Office Building
Washington, DC 20515

The Honorable Congressman Adam Smith
Ranking Member, House Armed Services Committee
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The Honorable Congresswoman Vicky Hartzler
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The Honorable Congressman Seth Moulton
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