KIRKLAND ALERT

September 2015

Federal Trade Commission Loses Motion to Enjoin Steris-Synergy Merger Based on Lack of Evidence of Future Competition

On September 24, 2015, the U.S. District Court for the Northern District of Ohio denied the Federal Trade Commission's ("FTC") motion for a preliminary injunction to prevent the merger of Steris Corporation ("Steris") and Synergy Health plc ("Synergy"), two providers of sterilization services for manufacturers predominantly in the healthcare industry.[1] Merger cases are rarely litigated, and the decision marks the first trial defeat in recent years for either of the U.S. antitrust agencies (the FTC and the Antitrust Division of the U.S. Department of Justice (collectively, the "Agencies")), each of which has been successful in its active approach towards merger enforcement during the Obama Administration. In addition, the court's analysis of the "actual potential competition" or "future competition" theory of harm — which posits that a merger between an existing competitor and a probable entrant in a concentrated industry may substantially lessen competition by depriving the marketplace of the competition that would have resulted from the entry — is informative, especially given that the theory has a controversial history but has continued to gain traction in recent Agency merger enforcement actions.

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Background

In October 2014, Steris announced its agreement to merge with UK-based competitor Synergy in an inversion transaction worth $1.9 billion. Steris provides sterilization services in the U.S. using gamma radiation, e-beam radiation and ethylene oxide gas ("EO"). Steris and its primary competitor Sterigenics are the only U.S. competitors that offer gamma radiation sterilization (a preferred option required for some healthcare products due to its dense penetration capabilities) and together account for 85 percent of the U.S. market for contract sterilization services. Synergy, which also offers contract radiation and EO sterilization services, is a much smaller competitor than Steris or Sterigenics in the U.S. and does not have a U.S. gamma radiation sterilization facility, but has a strong presence outside the U.S. Critically, Synergy has been working to develop a new x-ray sterilization technology in the hopes of increasing its U.S. market presence at the expense of Steris' and Sterigenics' gamma radiation services.

In May 2015, the FTC filed a complaint seeking to enjoin the merger, arguing that Synergy was likely to enter U.S. x-ray sterilization, which "would have resulted in substantial deconcentration, lower prices, and an important new technology for U.S. sterilization customers."[2] In particular, the FTC alleged that the relevant product market (defined as "no broader than contract radiation sterilization services")[3] is highly concentrated with two major players, that Synergy's entry into U.S. x-ray sterilization is probable and would augment competition, and that no other firms

are positioned for entry in either gamma radiation or x-ray sterilization. In response, the defendants challenged the application of the actual potential competition doctrine, citing Supreme Court precedent that declined to endorse the doctrine,[4] and argued that Synergy's entry into x-ray sterilization was improbable.

Until a court squarely addresses the issue, the Agencies will likely continue to pursue merger enforcement actions based on actual potential competition arguments even though the application of the doctrine invites speculation.

Decision

Despite the defendants' argument that actual potential competition "has long been disfavored by numerous courts including the Supreme Court," the court deferred judgment on the issue and assumed the validity of the doctrine, instead focusing its analysis on the factual probability of Synergy's entry into U.S. x-ray sterilization.[5] In that issue, the court found that Synergy's entry was not, in fact, likely because (1) Synergy has no customer commitments, a prerequisite for formal board consideration of the plan to expand into U.S. x-ray sterilization, even though it has undertaken significant efforts to enlist customers, (2) the economics of switching from gamma radiation to x-ray sterilization does not make sense for customers, and (3) the capital costs of building U.S. x-ray facilities leads to low projected returns on investment, which makes expansion into U.S. x-ray sterilization unpalatable for Synergy. The court also disagreed with the FTC's assertion that the pendency of the merger, rather than legitimate business reasons, caused Synergy to abandon its entry into U.S. x-ray sterilization, finding that "the problems that plagued the development of x-ray sterilization as a viable alternative to gamma sterilization in 2012 . . . were the same problems that justified termination of the project in 2015: the failure to obtain customer commitments and the inability to lower capital costs."[6] On these grounds, the court denied the FTC's motion for preliminary injunctive relief.

Takeaways

Given that the case law on actual potential competition is scant and provides relatively little guidance, it is perhaps unsurprising that the Northern District of Ohio did not weigh in on the validity of the doctrine. Until a court squarely addresses the issue, the Agencies will likely continue to pursue merger enforcement actions based on actual potential competition arguments even though the application of the doctrine invites speculation.[7] Indeed, the Agencies' Horizontal Merger Guidelines provide express support for the actual potential competition theory[8] and the Agencies have a successful track record in advocating for the application of the doctrine in recent merger enforcement actions, including the recently abandoned Applied Materials/Tokyo Electron merger and the Nielsen/Arbitron merger, which was resolved by consent order.[9] As such, clients considering a horizontal merger in a concentrated industry, especially one where the innovation of new products and services plays an important role, should be sure to assess the merger's likely effect on future competition — including whether the merger eliminates a likely potential future competitor in a concentrated market — when assessing the antitrust risk profile of the transaction.

More broadly, this case shows both the willingness of the FTC to pursue nontraditional antitrust theories and the difficulty such cases may face in the federal courts. In another example that Kirkland & Ellis successfully litigated last year, the FTC

lost a motion to dismiss in a non-merger pay-for-delay case in which the FTC, after voting 3-2 to file the complaint, claimed that two agreements — although concededly procompetitive individually — were anti-competitive when combined.[10]

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1 Order, Fed. Trade Comm'n v. Steris Corp., Case No. 1:15 CV 1080 (N.D. Ohio Sept. 24, 2015), *available at* https://www.law360.com/dockets/download/56042a1d257d677a95000001?doc_url=https%3A%2F%2Fecf.ohnd.uscourts.gov%2Fdoc1%2F14118002710&label=Case+Filing.

2 Reply Memorandum in Support of Plaintiff Federal Trade Commission's Motion for Preliminary Injunction at 9, Fed. Trade Comm'n v. Steris Corp., Case No. 1:15 CV 1080 (N.D. Ohio Sept. 24, 2015), *available at* https://www.ftc.gov/system/files/documents/cases/150814ftcsterisbriefreply.pdf.

3 Memorandum in Support of Plaintiff Federal Trade Commission's Motion for Temporary Restraining Order and Preliminary Injunction at 7, Fed. Trade Comm'n v. Steris Corp., Case No. 1:15 CV 1080 (N.D. Ohio Sept. 24, 2015), *available at* https://www.ftc.gov/system/files/documents/cases/150504ecfmemo.pdf.

4 *See, e.g., United States v. Marine Bancorp.*, 418 U.S. 602, 623–25, 639-40 (1974) ("Unequivocal proof that [a merging party] actually would have entered de novo but for a merger is rarely available. . . . Although the concept of perceived potential entry [which relates to whether a merging party that does not compete in a relevant market with the other merging party, but which is perceived by competitors as a potential entrant and therefore has a procompetitive influence in the market] has been accepted in the Court's prior Section 7 cases, the potential-competition theory upon which the Government places principal reliance in the instant case has not. The Court has not previously resolved whether the potential-competition doctrine proscribes a market extension merger solely on the ground that such a merger eliminates the prospect for long-term deconcentration of an oligopolistic market that in theory might result if the [merging party] were forbidden to enter except through a de novo undertaking or through the acquisition of a small existing entrant (a so-called foothold or toehold acquisition). [United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973)] expressly reserved this issue.").

5 Order at 6, Fed. Trade Comm'n v. Steris Corp., Case No. 1:15 CV 1080 (N.D. Ohio Sept. 24, 2015), *available at* https://www.law360.com/dockets/download/56042a1d257d677a95000001?doc_url=https%3A%2F%2Fecf.ohnd.uscourts.gov%2Fdoc1%2F14118002710&label=Case+Filing.

6 *Id.* at 40.

7 Because of the practical difficulties in applying the doctrine, the leading antitrust treatise recommends that it be abandoned. *See* Philip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles And Their Application ¶1134 (2015) ("[Historically,] analyzing potential competition mergers required heroic speculation about likely or probable events, and the competitive consequences of potential rivals' entry by alternative means. In order for the theories to work, markets had to have sufficiently high entry barriers so that nearly all firms were unlikely entrants, but yet there had to be a small number of firms with an identifiable entry advantage that made them sufficiently likely entrants. . . . In sum, applying the potential competition doctrines generally required tribunals to pile one highly speculative conclusion upon another, resulting in an unacceptable propensity for error.").

8 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines §5.3 (2010), *available at* https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

9 Press Release, Fed. Trade Comm'n, "FTC Approves Nielsen Holdings N.V. and Nielsen Audio, Inc.'s Application to Sell its LinkMeter Technology and Related Assets to comScore, Inc." (Apr. 2,

2014), *available at* https://www.ftc.gov/news-events/press-releases/2014/04/ftc-approves-nielsen-holdings-nv-nielsen-audio-incs-application; Press Release, Dep't of Justice Antitrust Division, "Applied Materials Inc. and Tokyo Electron Ltd. Abandon Merger Plans After Justice Department Rejected Their Proposed Remedy" (Apr. 27, 2015), *available at* http://www.justice.gov/sites/default/files/atr/legacy/2015/04/27/313505.pdf.

10 Fed. Trade Comm'n v. AbbVie Inc., 2015 U.S. Dist. LEXIS 59115 (E.D. Pa. May 6, 2015).

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