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FTC Merger Challenge Based on Harm to Potential Competition Rejected by District Court

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In what has become rare of late, the Federal Trade Commission ("FTC") suffered a litigation loss in a merger case with a district court's denial of a preliminary injunction to block the deal pending administrative litigation. *FTC v. Steris Corporation*, 1:15-cv-01080 (N.D. Ohio September 24, 2015). The FTC's case was based on the "actual potential entrant" doctrine which focuses on harm to likely *future* competition—differing from traditional merger challenges based on harm to direct current competition. Assuming the infrequently used and often challenged doctrine as valid for preliminary injunction purposes, the district court found that the FTC failed to show that the target company probably would have entered the relevant market as a new competitor but for the proposed merger. On October 1, 2015, the FTC issued a statement that it had decided not to appeal the district court's decision.

Last October, Steris Corporation ("Steris"), an Ohio-based maker of hospital sterilization products, agreed to buy Synergy Health plc ("Synergy"), a provider of sterilization services for medical-device manufacturers, hospitals and other industries based in England for $1.9 billion. Steris and Synergy are the second- and third-largest sterilization companies in the world. Sterigencis International LLC ("Sterigencis") is the largest. Sterilization is the critical final step in the manufacture of many healthcare-related products, required by the Food and Drug Administration to ensure the products are free of unwanted microorganisms. The majority of sterilization is outsourced by the manufacturers to companies like Steris and Synergy. While there are three contract sterilization methods currently used in the U.S., gamma sterilization is the most effective and economical option for healthcare products. Steris and Sterigencis together account for approximately 85% of all U.S. contract sterilization services.

Synergy is the largest provider of one of the other methods of sterilization in the U.S., and operates many gamma facilities outside the United States. Synergy also operates an x-ray sterilization facility in Switzerland—the only facility in the world providing x-ray sterilization services on a commercial scale. X-ray sterilization could provide a competitive alternative to gamma sterilization, but is not currently available in the United States. In 2013, Synergy began investigating the possibility of establishing an x-ray sterilization facility in the United States.

The FTC's Theory

The FTC concluded after its investigation of the proposed transaction that it would violate Section 7 of the Clayton Act, and in May sought injunctive relief under Section 13(b) of the Clayton Act.[1] Section 13(b) authorizes a court to grant a preliminary injunction if the FTC raises "questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC."

Under the actual potential entrant doctrine, "the FTC asserted that the acquisition of an actual potential competitor violates Section 7 if (1) the relevant market is highly concentrated, (2) the competitor 'probably' would have entered the market, (3) its entry would have had pro-competitive effects, and (4) there are few other firms that can enter effectively."

The District Court's Decision

The case law on potential competition is somewhat dated and sparse, and the merging parties asserted that the actual potential entrant doctrine is disfavored. Nonetheless, for purposes of the preliminary injunction motion, the district court assumed its validity. The district court directed the parties to focus on the second prong: "whether, absent the acquisition, the evidence shows that Synergy probably would have entered the U.S. contract sterilization market by building one or more x-ray facilities within a reasonable period of time."

The district court concluded that the FTC failed to carry its fact-based burden.

The opinion recapped in detail the evidence surrounding Synergy's efforts to establish an x-ray sterilization facility in the United States. The key dispute between the FTC and the merging parties was not about whether Synergy pursued such a business strategy—they agreed that it did—but rather they disputed why Synergy abandoned the effort. The merging parties argued that the strategy was abandoned because Synergy concluded that "there was no reasonable prospect of customer acceptance for Synergy's X-ray project." The FTC countered that Synergy was poised to enter the U.S. market in 2014, and only abandoned its plan because of the pending merger with Steris.

The district court delved into the factual record established in the three-day hearing and found that Synergy abandoned its U.S. x-ray plan due to legitimate business reasons separate from the planned merger, and thus the FTC failed to show that absent the merger Synergy probably would have entered the U.S. contract sterilization market by building x-ray facilities. First, the court held that the most significant reason for discontinuing Synergy's U.S. x-ray plan was lack of customer commitment. The district court found that not a single customer, despite significant effort by Synergy, was willing to provide the financial commitment necessary to build the x-ray facility. Second, the evidence showed that the customers' concerns were due to the significant cost of converting to a new method of sterilization without any significant benefit in x-ray sterilization over other methods. Third, Synergy was unable to obtain business approval internally for the capital costs to build the x-ray facilities. The investment would have consumed Synergy's entire discretionary budget, thus little risk would be tolerated by the company to pursue the plan. Fourth, the district court also found the sequence of the timing of the merger announcement and the abandonment of the x-ray plan was evidence supporting the merging parties' argument. The district court reasoned that the fact that Synergy continued to pursue its x-ray strategy after the merger was announced and only subsequently abandoned it "may actually be the best evidence that it was done for legitimate business reasons, as opposed to anti-competitive ones." The district court elaborated that had Synergy terminated its U.S. x-ray project when it began merger negotiations with Steris or when the merger was announced, it might have viewed the evidence differently.

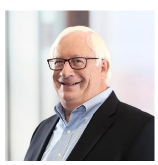
While the FTC has not recently suffered a litigation loss in a merger challenge, this case does not necessarily suggest a weakening in its merger enforcement efforts. Potential competition cases are arguably more difficult to win than traditional merger cases. As was seen here, they are heavily fact-dependent, and the FTC cannot rest on structural evidence and the *Philadelphia National Bank* presumption of harm from concentration increases in a narrowly defined market. And perhaps of value to the FTC here, is its ability to walk away without the actual potential entrant doctrine having been challenged by the district court.

This case also serves as an illustration of the appropriate conduct merging parties should adhere to pre-close. Synergy and Steris won here because Synergy actively continued to operate its business as usual despite the pending merger, including pursuing its competitive business strategies. Had Synergy abandoned its U.S. x-ray plans *because of* the proposed merger, not only would the FTC have likely won its preliminary injunction motion, but the parties might have faced an antitrust "gun jumping" challenge as well. Under the antitrust laws, merging competitors must continue to operate and vigorously compete with each other until the transaction closes. Synergy and Steris appeared to do just that.

Endnote

1 http://www.mintz.com/newsletter/2015/Advisories/4992-0615-NAT-AFR/

Authors



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