Pepper Hamilton LLP
Attorneys at Law

CLIENT ALERT

September 9, 2015

Federal Judge in Ohio Accepts Future Competition Theory: Parties Should Proceed with Caution in Deals to Acquire Potential Competitors

Barbara T. Sicalides | sicalidesb@pepperlaw.com
Benjamin J. Eichel | eichelb@pepperlaw.com

THE COURT'S DECISION IN FTC V. STERIS DEMONSTRATES THE IMPORTANCE OF CONDUCTING A THOROUGH ANTITRUST ANALYSIS OF ALL ASPECTS OF A MERGER OR ACQUISITION FROM EVERY POSSIBLE ANGLE, INCLUDING LIKELY FUTURE COMPETITION.

On August 19, the U.S. District Court for the Northern District of Ohio accepted the Federal Trade Commission's (FTC's) "actual potential entrant" theory in connection with its review of the FTC's request for a preliminary injunction of Steris Corporation's $1.9 billion acquisition of Synergy Health plc. This decision may be the beginning of a move by the agencies to start challenging transactions involving potential competitors and may put companies considering acquisitions of potential competitors at greater risk.

Background

Steris and Synergy are the second- and third-largest product sterilization companies in the world. Sterigenics International, Inc. is the largest. Sterilization is an important step in the manufacture of many healthcare products, as it eliminates bacteria and other microorganisms living on products and is required by the Food and Drug Administration (FDA).

Steris is one of two U.S. providers of gamma sterilization services, while Synergy operates more than three dozen contract sterilization facilities, including numerous gamma sterilization facilities outside of the United States. According to the FTC, currently, Synergy is only a small U.S. contract radiation player because it offers only e-beam sterilization services, but it is "an actual potential entrant" with its X-ray sterilization business, which would substantially augment its competitive significance. "Synergy's entry with contract x-ray services would reduce concentration substantially in each relevant market and result in other procompetitive effects."[1]

FTC v. Steris

The FTC claimed that, but for the proposed acquisition, Synergy was likely to enter the U.S. market by establishing an X-ray sterilization facility that would compete with Steris and Sterigenics "within a reasonable time frame."[2] Citing a treatise, the FTC delineated the elements it contends it needs to prove to demonstrate that the acquisition of an actual potential competitor violates section 7 of the Clayton Act[3]:

- the relevant market is highly concentrated
- the competitor "probably" would have entered the market
- its entry would have had procompetitive effects
- there are few other firms that can enter effectively.[4]

Steris and Synergy opposed the injunction by arguing that, under the antitrust laws, a merger should be upheld so long as there is not a reduction in "pre-existing substantial competition."[5] They further argued that the actual potential entrant doctrine is disfavored by the courts and has rarely been adopted.

Following a preliminary injunction hearing, the Ohio court issued an order, stating "[s]ince the FTC has endorsed the 'actual potential entrant' theory in filing this Complaint, the Court will accept it for purposes of its decision."[6] The court further directed the parties "to address the following question: But for the merger, is it probable that Synergy would have entered the U.S. market by building one or more x-ray sterilization facilities in the U.S. in a reasonable period of time?"[7]

The Role of Potential Competition in Merger Analysis

The concept of potential competition as part of merger analysis is not entirely new. Section 7 bars acquisitions that may substantially lessen competition, and, as a result, its application is inherently forward-looking. In addition, the 2010 Horizontal Merger Guidelines define "horizontal mergers" as including "mergers and acquisitions involving actual or potential competitors."[8] The guidelines further note that, in evaluating evidence of direct competition, the agencies will "consider whether the merging firms have been, or *likely will become absent the merger*, substantial head-to-head competitors."[9]

There is little clarity or history regarding when potential competition is meaningful or sufficiently likely to play a factor in the ultimate analysis or trigger the special antitrust issues raised in connection with due diligence and preclosing integration. Among the factors that should be considered are the following:

- whether the potential competitor has entered into commitments with customers or vendors
- the existence of other potential competitors and how their progress compares with the potential competitor that is a party to the contemplated transaction
- whether significant barriers remain to the entry of the potential competitor
- the likely timing of entry if matters progress as they were progressing before serious consideration of the transaction at issue
- the speed at which the market is evolving, including related technology, and where the potential competitor stands in the evolution process.

Chief among the tools used to assess these factors are the parties' public statements and internal documents regarding or reflecting all potential competition. If the parties intend to argue that plans for market entry have either been dropped or delayed and their internal documents do not reflect that decision, the risk is high that the applicable agency will not accept the parties' argument. The agencies will view skeptically any effort to document that decision after the parties have begun serious consideration of the contemplated transaction. Accordingly, the parties should muster any preexisting evidence to back up the logic of the decision or the reasons underlying the decision, as well as any nonparty evidence. Additionally, evidence of other independent potential competitors could be key. Other equally well-positioned or likely potential competitors would eliminate much of the risk of a merger with another possible competitor.

Parties and advisors anxious to push transactions forward are often resistant to putting in place proper preclosing antitrust protocols when one of the two parties involved is only a potential competitor, as compared to an actual competitor. For example, where the buyer or target company is only a potential competitor, advisors often argue that diligence can be exchanged freely without restrictions on access to customer-specific competitively sensitive information.

The *Steris* court's ready acceptance of the "actual potential entrant" theory may mark the beginning of a shift in the agencies' willingness to challenge transactions involving potential competitors and a greater risk for companies considering acquisitions with potential competitors. Such companies, like direct competitors, should limit the exchange of competitively sensitive information to only that which is reasonably necessary to consummate the transaction and should not exchange the following:

- customer-specific or product-specific pricing
- customer-specific or product-specific margins
- terms of specific significant vendor arrangements.

Instead, this type of competitively sensitive data should only be disclosed in aggregated, summary or historical form, such that the receiving party is unable to reverse engineer the information to influence its future pricing, sales or purchasing activities.

Moreover, the *Steris* decision demonstrates the importance of conducting a thorough antitrust analysis of all aspects of a merger or acquisition from every possible angle, including likely future competition. The FTC will focus not just on how the market looks today, but how the market could look tomorrow and beyond. A review of internal business planning documents, as well as interviews of key client personnel most familiar with the market, equipment, intellectual property and other factors necessary for success in the market, and strategic options under consideration at all levels of the business remains important. And, in cases involving potential competition, more important than ever.

Endnotes

1. FTC Complaint, *FTC v. Steris Corp.*, No. 1:15-cv-01080-DAP, at 6 ¶11 (N.D. Ohio filed May 29, 2015), *available at* https://www.ftc.gov/system/files/documents/cases/150529sterissynergytro.pdf.

2. Post Hearing Brief for FTC, *Steris*, No. 1:15-cv-01080-DAP, at 2 (N.D. Ohio filed Aug. 28, 2015), *available at* https://www.ftc.gov/system/files/documents/cases/150828posthearingbrief.pdf.

3. The FTC's complaint relies not only on section 7, but also on section 5 of the FTC Act. As the FTC has made clear, it intends to rely on section 5 in matters where the challenged conduct is "likely to cause[] harm to competition". Donald S. Clark, Sec'y, FTC, Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (Aug. 13, 2015), *available at* https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf.

4. Brief for FTC, *Steris*, No. 1:15-cv-01080-DAP, at 6 (N.D. Ohio filed June 4, 2015), *available at* https://www.ftc.gov/system/files/documents/cases/150504ecfmemo.pdf.

5. *See Int'l Shoe Co. v. FTC*, 280 U.S. 291, 298 (1930).

6. Scheduling Order, *Steris*, No. 1:15-cv-01080-DAP (N.D. Ohio filed Aug. 20, 2015) available at https://www.ftc.gov/system/files/documents/cases/150820ecfschedulingorder.pdf.

7. *Id.*

8. *See* U.S. Dep't of Justice & the Fed. Trade Comm'n, Horizontal Merger Guidelines, at § 1 (Aug. 19, 2010), *available at* http://ftc.gov/os/2010/08/100819hmg.pdf.

9. *Id.* at § 2.1.4 (emphasis added).