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The FTC's Recent Challenge of the Steris/Synergy Transaction Highlights the Impact of "Likely Future Competition" in Merger Control Analysis

On May 29th, 2015 the U.S. Federal Trade Commission ("FTC") issued an administrative complaint against Steris Corporation's ("Steris") $1.9 billion proposed acquisition of Synergy Health plc ("Synergy"). Simultaneously the FTC Commissioners also authorized the FTC staff to seek a temporary restraining order and preliminary injunction in federal court to enjoin the transaction and ensure the companies remain separate pending the administrative trial. According to the FTC the transaction would violate the U.S. antitrust laws, namely Section 7 of the Clayton Act and Section 5 of the FTC Act, by harming competition for contract radiation sterilization services. Synergy is not currently an active participant in this market, but the FTC alleges that the transaction would eliminate "likely future competition," between the two transacting parties.

Steris and Synergy are two of the three largest sterilization service providers in the world. Sterilization services are used by manufacturers, particularly those in the healthcare field, as a final step in the manufacturing process to ensure that products are free of microorganisms that may cause infections. One type of sterilization is gamma radiation, which uses the radioactive isotope Cobalt 60. According to the FTC, the only substitute for gamma radiation sterilization is X-ray radiation sterilization. While other sterilization methods exist, these other methods are not close substitutes for radiation sterilization. Moreover, because of the cost and expertise required to conduct the sterilization, few manufacturers conduct the sterilization in-house. Instead, manufacturers ship products to third-party sterilization service providers, typically to a facility within a 500-hundred mile radius.

In the U.S. Steris is one of only two providers of gamma radiation sterilization services. Synergy does not currently operate any gamma radiation sterilization facilities in the U.S., but does offer other types of sterilization in the U.S. The FTC alleges, however, that Synergy not only planned to begin offering competing X-ray radiation sterilization services in the U.S., but that Synergy had begun implementing this plan at the time of the announced transaction. For this reason, the FTC claims that the acquisition "would eliminate likely future competition," between Steris and Synergy for radiation sterilization services. Not only does the FTC allege that Synergy's planned X-ray radiation technology would be a strong competitive constraint against gamma radiation sterilization; but also, because of the significant time it takes to research, test, and obtain governmental approvals, combined with the fact that Synergy has a 10-year exclusive agreement with the world's only manufacturer of the X-ray sterilization machines, the FTC believes that no other potential entrant is likely for this service.

Based on the publicly available administrative complaint, it appears that the FTC's theory of Synergy's potential entrance into the market stems from documents received in response to requests for additional information (a.k.a. "Second Requests") issued by

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the FTC in January 2015, discussions with market participants and customers, as well as depositions of company employees. For example, the FTC cited to a 2012 proposed plan made at a Synergy leadership conference, letters of interest that Synergy had sent to customers in the Summer of 2014 to gauge potential customers for Synergy's X-ray services, strategic plans, and presentations to Synergy's board of directors. This information apparently showed that Synergy had not only planned to enter the U.S. market, but it had, in fact, begun implementing those plans. Documents also indicated that Synergy had internal projections of how much business it could take from Steris.

While the evidence relied upon in the administrative complaint paints a picture in which Synergy's future entry into the market for radiation sterilization services appeared almost definite absent the transaction, the question remains: how likely must entrance be? As the FTC and Department of Justice's (together the "U.S. Agencies") joint Horizontal Merger Guidelines state, when analyzing a transaction the U.S. Agencies consider whether the parties are "likely" to become competitors absent the merger. Shortly after the administrative complaint was announced in the Steris matter, FTC Chairwoman Edit Ramirez made statements indicating that "certainty" of entrance is not required. As she stated, the FTC "may not be able to know everything about a market and its likely future, but *certainty is neither practical nor necessary, and the absence of certainty shouldn't keep us from making reasonable judgments* based on what we do know." (emphasis added).

Although in this instance the FTC is relying on a theory of "likely future competition," to block the Steris and Synergy transaction, there have been other recent instances in which parties have successfully argued that "likely future competition" from third parties provided sufficient competitive restraints to allow a transaction to proceed. For example:

- In the XM-Sirius Satellite Radio merger the DOJ cited potential future competition as one rational for closing its investigation into the merger and allowing it to proceed. The DOJ believed that new technologies under-development at the time, such as wireless streaming services, were "likely" to provide alternatives to the joint satellite radio provider.
- Similar arguments were relied upon by the FTC when it closed its investigation into Google's acquisition of AdMob in 2010. Google and Admob were the two largest mobile advertising networks, which sold advertising space for mobile publishers, and regularly competed against one another. Despite this fact, the FTC permitted the deal to proceed largely because it believed developments in the market indicated the likely introduction of competition from new market participants; namely, Apple had plans to launch its own advertising network. Coinciding with its iPhone, the FTC believed that Apple was "poised to become a strong competitor," to the combined Google/AdMob.

The possibility that a merger will eliminate potential, future competition has also led to transactions being blocked or subject to remedies in other jurisdictions. For instance, one of the reasons that the European Commission prohibited the proposed merger between NYSE Euronext and Deutsche Börse in 2012 was that, even where only one of the parties offered trading of a particular product on its platform, the other party was "uniquely placed" to launch a competing offer at short notice. This threat of entry, said the Commission, was likely to have a significant impact on prices. It based its conclusions on historical evidence of attempts by the parties to enter each other's markets (both failed and successful) as well as internal documents of the parties indicating that they had considered doing so more recently – despite the parties protests' that these discussions were merely "internal brainstorming" and that they "were never seriously pursued and did not result in any concrete action". On appeal, the General Court of the EU emphasized the need for theories of harm relating to potential competition to be backed by "convincing" evidence, but said that the Commission had met this standard.

They key take-away from each of these matters, and others like them, is that transacting parties must consider future competition, even "likely" competition, when evaluating the competitive effects of a transaction. From a due diligence perspective, it is important to know whether a target entity has plans to enter a relevant market, how far along those plans are, and whether it is "likely" that other new entrants exist. Likewise, if regulators are examining a transaction, it is possible to successfully argue that future market entrants are a means of protecting competition. This is particularly true in dynamic and emerging markets.

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