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No X-Ray Vision at the FTC: Court Hands Agency a Rare Defeat in the Steris/Synergy Merger

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In *FTC v. Steris*, the FTC was handed a rare litigation defeat. The case was notable because it involved a merger between companies who were not current competitors. The FTC alleged that without the merger, Synergy would have entered the US sterilization market with a disruptive new technology that would have undermined the current duopoly and benefited customers. The court found little in the evidence to support the FTC's theory. To be sure, there will be some soul-searching at the FTC as to how the Court could find the weight of the evidence so strongly on the side of the merging parties. However, because the case was decided on the single factual question of whether Synergy would have entered the U.S. market independently, the case has little precedential value and is unlikely to significantly alter the FTC's general approach to mergers involving potential competitors.

Introduction

In *FTC v. Steris*, District Court Judge Polster handed a rare defeat to the FTC. The case was notable because it involved a merger between companies who were not current competitors. The FTC alleged that without the merger, Synergy would have entered the US sterilization market with a disruptive new technology that would have undermined the current duopoly and benefited customers. The case was therefore about a merger that eliminated only future or actual potential competition.

Although potential competition concerns are not novel for the FTC, this case was closely watched because it promised to be the first judicial treatment of potential competition in many years. Unfortunately for antitrust lawyers, the decision is something of a missed opportunity: the Court did not examine the validity or scope of the potential competition doctrine. Instead, the case was decided on the single question of whether the evidence showed that Synergy would have entered the US market within a reasonable period.

On this key threshold question—which the Court rightly identified as the decisive issue—the Court found the evidence unequivocally supported the merging parties. The Court found

that—given the enormous technical, financial, and business hurdles to entry and the notable lack of any customer commitments to an unproven technology—the FTC could not show that Synergy probably would have entered the market but for the merger.

Background

On October 13, 2014, the parties announced Ohio-based Steris' proposed acquisition of UK-based Synergy, for approximately $1.9 billion, which would combine the second and third largest medical sterilization companies in the world. Steris and Synergy claimed that the transaction would combine their geographically complementary businesses.

Steris was one of only two US providers of contract gamma radiation sterilization services. Gamma radiation sterilization is the most effective and economical option for many healthcare products that are required to be sterilized by the FDA. Gamma radiation sterilization in the US is essentially a duopoly, with the top two providers accounting for about 85% of the market. By contrast, Synergy had only a small sterilization presence in the United States, with no US gamma offering.

Although Synergy did not currently compete with Steris, the FTC focused on Synergy's plans to enter the United States with new x-ray based sterilization technology. After an intensive Second Request investigation, the FTC filed a complaint in the Northern District of Ohio seeking injunctive relief against the proposed transaction, alleging that Synergy would have become a significant competitor to Steris in contract sterilization services and that Synergy abandoned its entry plans because of the merger. The FTC also issued an Administrative Complaint challenging the merger.

Key Factors in the Decision

The court requested briefing and held three days of hearings in which it listened to testimony from Synergy executives as well as representatives from potential customers J&J and Zimmer. The Court found no support for the FTC's contention that Synergy abandoned its entry plans because of the merger. Instead, the Court decided that Synergy abandoned the project for legitimate business reasons unrelated to the merger. In the court's view, a lack of customer commitment, the inability to lower capital costs and other problems "plagued the development of x-ray sterilization" and justified Synergy's decision to terminate the entry project.

While the FTC argued that Synergy's ordinary course documents established that the company was "poised" to enter the US with disruptive technology and an expectation of winning the incumbents' highest-valued customers, Synergy maintained that the documents painted a bleak outlook for the project, an assessment that the court accepted. Synergy's business models showed the entry strategy would fail every one of Synergy's internal financial metrics. In addition, while Synergy's Board had endorsed the idea, a formal business plan for US entry had never been presented to or approved by the Board.

The court focused heavily on the risk profile of Synergy's entry strategy, noting that the investment was a "bet the farm" proposition that would consume Synergy's entire annual discretionary budget. Critically, any investment decision would also need to be backed by long-term commitments from customers. However, despite intense marketing and sales efforts, Synergy was unable to obtain a single customer commitment to x-ray technology. Because of the high costs in obtaining FDA-validation for x-ray sterilization, the court observed that there was no financial incentive for customers to switch from existing technology to x-ray based services.

The FTC asserted that it was the proposed merger and the FTC's own investigation into the deal that prompted Synergy to abandon its x-ray plans. Once again, the court disagreed, observing that Synergy did not terminate its plans until February 24, 2015, four months following the deal's announcement. Judge Polster noted that, "the timing of the decision

to pull the plug on the US x-ray project may actually be the best evidence that it was done for legitimate business reasons, as opposed to anti-competitive ones. If the merger with Steris was going to prevent Synergy from entering the US market, Synergy would have stopped working on the US x-ray project as soon as the merger was announced in mid-October 2014."

In the court's assessment, the x-ray entry strategy faced insurmountable hurdles that justified the decision to abandon the project entirely. Accordingly, the FTC could not carry its burden of establishing that Synergy would have entered the US market within a reasonable period but for the merger.

Conclusion

While the FTC may decide to appeal and/or may continue its in-house administrative proceedings against the merger, the prospects of a successful appeal are low. The decision was based on three days of oral hearings involving numerous determinations of witness credibility and a careful review of documentary evidence. To the extent it comes before the Court of Appeals, it will pay special deference to the District Court's account of the evidence and, if plausible, will not overturn the trial court even if it might have weighed the evidence differently.

Although there will be some soul-searching at the FTC as to how the Court could find the weight of the evidence so strongly on the side of the merging parties, the case is likely to have little impact on the FTC's general approach in potential competition cases. Indeed, if there is any solace for the FTC in this matter, it is that the Court was at least prepared to assume the validity of the actual potential competition doctrine rather than narrowly interpreting it in a way that may have constrained the Government's ability to challenge transactions on similar grounds in the future.

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