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The FTC's First Loss in Nearly Half a Decade, Illuminating the Difficulties of Prediction and the Merits of Litigating It

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"Prophesy is a good line of business, but it is full of risks." Mark Twain could have been speaking about the FTC's recent challenge to a merger between the second- and third-largest sterilization companies in the world, Steris Corporation and Synergy Health. *FTC v. Steris Corp.*, 2015 WL 5657294 (N.D. Ohio 2015). However, for the first time in four years, the FTC's bid for a preliminary injunction was denied. The FTC argued it had enough evidence to show the merger would have harmed competition in the future, but the court found there were too many uncertainties to support the FTC's prophecy. After the defeat, the FTC announced it would not appeal the decision, and last week, it withdrew its challenge to the Steris-Synergy merger. While one loss is not a trend, it cannot be said that the government always wins.

Potential Competition in Innovation Markets

The FTC challenged the Steris-Synergy merger under a theory called "potential competition," which is used to challenge mergers in innovation markets. Though the theory is somewhat controversial – innovation has been described as "one of the most heated discussions in economic circles"[1] – the FTC has not shied away. It has been bringing innovation market cases since the 1970s, and gave innovation markets formal recognition in the 1995 Antitrust Guidelines for the Licensing of Intellectual Property.

As for the potential competition theory, the 2010 Merger Guidelines describe it as applicable "if one of the merging parties has a strong incumbency position and the other merging firm threatens to disrupt market conditions with new technology or business model, their merger can involve the loss of actual or potential competition." To secure a preliminary injunction under a potential competition theory in *Steris*, the FTC had to demonstrate that "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." In other words, the FTC had to show it was reasonably plausible that market entrance would have occurred in the future, but for the merger.

Most antitrust disputes deal in predictive analysis of some kind, often in predicting what the "but for" world would look like absent challenged conduct. And in modern antitrust practice, these predictions often rely heavily on experts and economic analysis. Predicting whether a merger would have an anticompetitive effect on technological innovation or future market entrance, however, relies more on factual inferences than economic analysis. As former FTC Chairman Timothy Muris said in 2004, "economic theory and empirical investigations have not established a general causal relationship between innovation and competition [so] a careful, intense factual investigation is necessary."[2]

Still, the FTC has taken particular note of innovation markets in recent years. While it has focused on generic pharmaceutical mergers, it also has branched out to other markets such as automotive starter-ignition markets.

Synergy's Quest for X-ray Sterilization

In the *Steris* case, the FTC argued Synergy was likely to enter the U.S. market with a new, innovative X-ray sterilization technology. The U.S. market is dominated by a duopoly offering gamma sterilization, and during the years leading up to the announced merger with Steris, Synergy had been pursuing the development of X-ray sterilization facilities in the United States. The new technology would offer customers a cheaper alternative to gamma sterilization. No one else was doing it in the United States, and Synergy believed it could offer sterilization services to its customers – mostly manufacturers of medical equipment – for a lower cost.

But in a fact-intensive decision, the court found the FTC could not meet its burden for two main reasons: 1) customer reluctance to adopt a new, untested technology; and 2) Synergy's internal, risk-averse capital project protocols.

There was no question Synergy *wanted* to bring X-ray sterilization technology to the U.S. It contracted with a manufacturer (IBA) to build a first-of-its-kind combination gamma and X-ray sterilization machine that could handle the capacity Synergy required. And it reached out to key customers to secure contracts.

But market forces were countervailing, and Synergy scrapped the project four months after announcement of the merger. First, its overtures to customers were met with "academic" interest but no desire to commit to the new technology. There were too many unknowns to switch away from the time-tested gamma method, and Synergy was unable to secure commitment from a single customer.

Second, IBA began expressing doubts it could build the X-ray machine. By the time of the merger, the machine still "had never been designed, built, tested or priced." In the end, the project was never even presented to Synergy's PLC Board, whose approval was required, because it "failed every one of the metrics Synergy uses to rank capital investments."

While the FTC argued it was telling that the X-ray business was scrapped only after announcement of the merger, the court focused on Synergy’s continued efforts to make the X-ray business plan work. The court found that "the evidence demonstrates that this was not a sham to convince the FTC that Synergy wanted to enter the market; it was a legitimate effort by Synergy employees who really wanted the project to succeed, but recognized the hurdles they needed to overcome to win approval."

The Future of Merger Challenges in Innovation Markets

The decision is unlikely to avert the FTC's focus from innovation markets, or reduce its willingness to pursue potential competition theories. But the decision shows that potential competition cases are indeed fact-intensive, and a careful marshaling and analysis of evidence can win the day, particularly where, as in the *Steris* case, the innovation in question is still multiple steps away from approval. When the FTC comes knocking, careful analysis is required, and the first reaction may not just be how to negotiate a settlement but how to win.

[1] Michael A. Carrier, *Two Puzzles Resolved: Of the Schumpeter-Arrow Stalemate and Pharmaceutical Innovation Markets*, 93 Iowa L. Rev. 393, 399 n.8 (2008)

[2] Statement of Chairman Timothy J. Muris in the matter of Genzyme Corporation / Novazyme Pharmaceuticals, Inc., *available here.*

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