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# 15. Potential Competition Mergers

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Merger Antitrust Law

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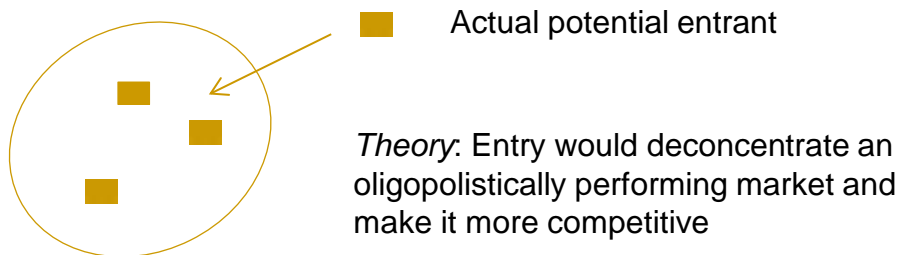
# Potential competition theories

- Elimination of actual potential competition
  - This theory looks directly to the elimination of possible future rivals through their acquisition before they can enter the market as independent participants
  - The idea here is that, in the absence of the acquisition, the potential entrant would have entered the market and its entry would have improved the competitive performance of the marketplace
  - Under this theory, the acquisition is anticompetitive because, on a forward-looking basis, the acquisition eliminated future rivalry and made the market less competitive than it would have been in the absence of the transaction
  
- Elimination of perceived potential competition
  - This theory looks to actions that incumbent firms in the market currently may be taking to discourage firms they perceive as potential future entrants from actually entering the market
  - These actions usually involve an increased level of competitive activity, which serves to lower returns from operating in the market and decrease the attractiveness of entry
  - According to this theory, if the perceived potential entrant is acquired, the incumbent firms will cease their efforts to discourage entry, and, as a result, the competitive performance of the marketplace will decline

# Actual potential competition

## ■ The idea

- Acquire a firm that that otherwise would have entered the market, reduced concentration, and increase competition—Acquisition eliminates in increase in future competition



- Acceptance by courts
  - The Supreme Court has reserved judgment on the elimination of actual potential competition<sup>1</sup>
- Not yet approved by the Supreme Court
  - But provisionally accepted by lower courts
  - Lower courts, the FTC, and the 1984 DOJ Merger Guidelines recognize the elimination of actual potential competition as an anticompetitive harm under Section 7
- Agencies have used to obtain consent decrees when:
  - The market is highly concentrated
  - Entry is almost certain in the immediate future

<sup>1</sup> See *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 625, 639 (1974); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 537-38 (1973).

# Actual potential competition

- Elements of the actual potential competition theory of harm
  1. Non-competitiveness
    - The relevant market in which the anticompetitive effect may occur must be operating non-competitively prior to the acquisition
    - If the market is operating competitively, new entry cannot improve the market's competitive performance
  2. Uniqueness
    - The putative potential entrant must be somewhat unique in its incentives and ability to enter the relevant market
    - If there are numerous other similarly situated potential entrants, the elimination of one through acquisition is unlikely to affect the long-run level of competition in the market
    - The conventional wisdom is that the agencies are unlikely to challenge a transaction under the actual potential competition doctrine if the entry advantages ascribed to the putative potential entrant is shared by three or more other firms

# Actual potential competition

## ■ Elements of the actual potential competition theory of harm

### 3. “Available, feasible means” of procompetitive entry

- The putative potential entrant must have the means of entering the market in a way that could possibly improve the competitive performance of the target market
- Courts recognize two types of procompetitive entry alternatives: de novo entry and “toehold” entry
  - For de novo entry to qualify as an “available, feasible means” of procompetitive entry, any barriers to entry into the market must not be so high as to be preclusive
  - For a toehold acquisition to qualify as an “available, feasible means” of procompetitive entry: (a) toehold firms must exist in the target market, which if acquired would provide a viable avenue to developing a significant market presence; and (b) such firms must be available for acquisition, presumably on objectively reasonable terms.

### 4. Incentive

- But for the acquisition, the putative potential entrant must have sufficient incentive to enter the market using one of the above means to make entry in the near future likely
- Evidence of intent to enter may be objective, but subjective intent reflected in regular course of business documents or management testimony is usually the most compelling

### 5. Procompetitive effect

- Assuming it occurred, such entry must materially improve the competitive performance of the market.

# Actual potential competition

## ■ Application

- *Typical application:* Pharmaceutical acquisition of a company with a competitive product near the end of the FDA approval process
- *Example: Actavis/Warner Chilcott*
  - When Actavis sought to acquire Warner Chilcott, the FTC alleged that the transaction would eliminate actual potential competition against three Warner Chilcott branded pharmaceutical products, since in the absence of the transaction Actavis would be the first to enter into the manufacture and sale of a generic competitor<sup>1</sup>
  - As a remedy, the Commission accepted a consent order that required Actavis to divest all of its rights and assets relating to generic versions of the drugs to Amneal Pharmaceuticals, a New Jersey-based generic pharmaceutical company that at the time marketed 65 products and maintained an active product development pipeline.
  - Actavis was also required to enter into an agreement to supply generic versions of the two of the products to Amneal for a period of two years, which Amneal could extend at its option for up to two additional one-year terms

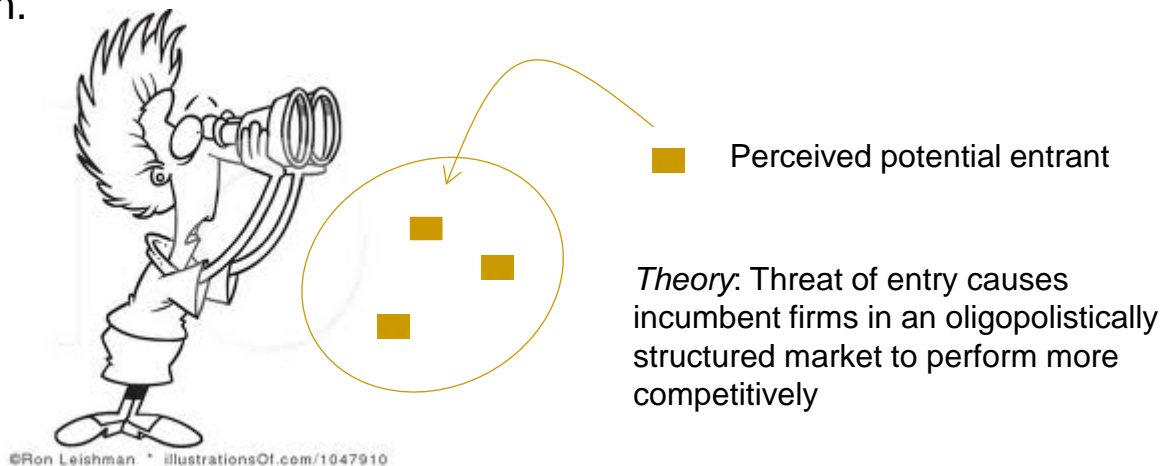
<sup>1</sup> Complaint ¶¶ 8-10, 12(b)-(c), *In re Actavis, Inc.*, No. C-4414 (F.T.C. issued Sept. 27, 2013) (settled by consent order).

<sup>2</sup> Decision & Order, *In re Actavis, Inc.*, No. C-4414 (F.T.C. issued Sept. 27, 2013); see Analysis of Agreement Containing Consent Orders To Aid Public Comment, *id.*

# Perceived potential competition

## ■ The idea

- Acquire a firm that incumbents fear will enter the market and hence have moderated their prices (“limit pricing”) to discourage that firm from actually entering
  - Acquisition eliminates the threat of entry and incumbent firms no longer have an incentive to moderate prices
- Theory recognized by the Supreme Court
  - Ironically, although the Supreme Court has recognized the elimination of perceived potential competition as a valid theory of anticompetitive harm, the agencies have used the theory rarely (if at all) since 1980 since it is almost impossible to show that incumbent firms have engaged in limit pricing to discourage entry
- There is no remedy for the elimination of perceived potential competition short of enjoining the transaction.



# Perceived potential competition

- Elements of the perceived potential competition theory of harm
  1. Non-competitiveness
    - In order for elimination of perceived potential competition to have any anticompetitive effect, the market must be susceptible to coordinated interaction.
    - An oligopolistic market structure is sufficient to satisfy this condition.
  2. Uniqueness
    - As under the actual potential competition doctrine, the perceived potential entrant must be perceived as somewhat unique in its incentives and ability to enter the relevant market.
    - If there are numerous other similarly situated potential entrants in the minds of incumbent firms, the elimination of one through acquisition is unlikely to affect the long-run level of competition in the market.
    - The conventional wisdom is that the agencies are unlikely to challenge a transaction under the actual potential competition doctrine if the entry advantages ascribed to the putative potential entrant is shared by three or more other firms.

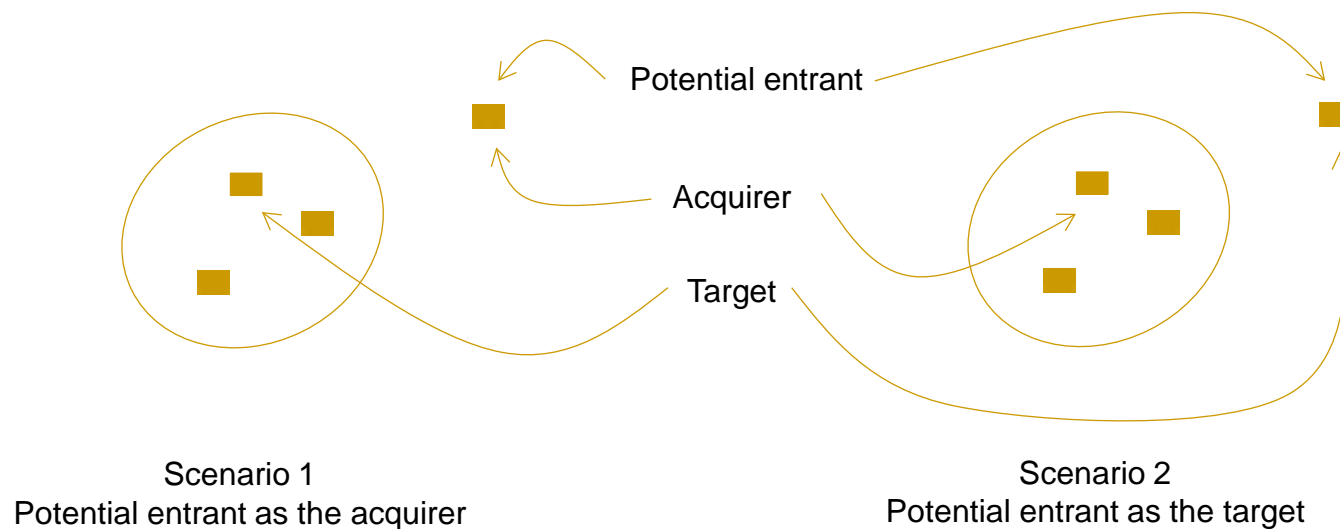


# Perceived potential competition

- Elements of the perceived potential competition theory of harm
  3. Perception as a likely potential entrant
    - Incumbent firms must perceive the firm as a likely potential entrant
  4. Incumbent reaction to threat of entry
    - Incumbent firms must be shown to be responding to the perceived threat of entry by lowering their prices, improving their product quality, or engaging in some other procompetitive activities in order to discourage the entry of the perceived potential entrant
  5. Anticompetitive effect
    - It must be in the profit-maximizing interest of incumbent firms to cease some or all of their procompetitive entry-deterring conduct as a result of the acquisition in question to the detriment of competition in the market

# Elimination of potential competition

- Under either theory, the potential entrant may be either the target or the acquirer



# Mylan/Perrigo



# Mylan/Perrigo

## ■ The deal

- On September 14, 2015, Mylan launched a hostile tender offer to acquire all outstanding ordinary shares of Perrigo for approximately \$27 billion (stock and cash)

## ■ Mylan

- American global generic and specialty pharmaceuticals company
  - Makes the EpiPen (~ 40% of Mylan's profit)
- 2015 revenues: \$9.42 billion

## ■ Perrigo

- American international manufacturer of private label over-the-counter pharmaceuticals
- 2013 revenues: \$3.45 billion

## ■ Backstory

- Mylan may have wanted to acquire Perrigo to fend off a \$40 billion hostile offer from Teva Pharmaceuticals

# Mylan/Perrigo

## ■ Actual overlaps

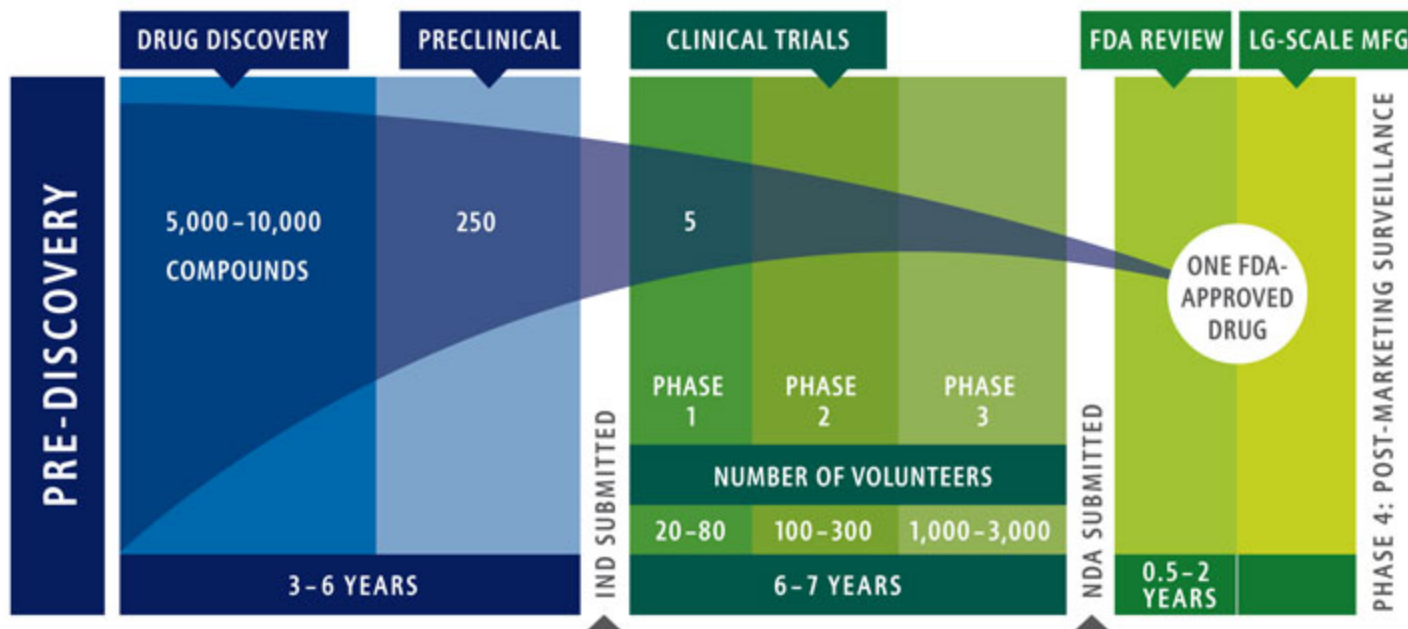
- Bromocriptine mesylate tablets
  - Treat conditions including type 2 diabetes and Parkinson's disease
- Clindamycin phosphate/benzoyl peroxide gels
  - Treat acne
- Liothyronine sodium tablets
  - Treat hypothyroidisms
  - Treats or prevents enlarged thyroid glands
- Polyethylene glycol 3350 OTC oral solution packets.
  - Laxative used to treat occasional constipation

## ■ Potential future overlaps

- Acyclovir ointment
  - Slows the growth and spread of the herpes virus in the body
- Hydromorphone hydrochloride extended release tablets
  - Treats moderate to severe pain in narcotic-tolerant patients
- Scopolamine extended release transdermal patches
  - Prevents symptoms associated with motion sickness
  - Helps patients recover from anesthesia and surgery

# Mylan/Perrigo

## Drug Discovery and Development: A LONG, RISKY ROAD



Source: Pharmaceutical Research and Manufacturers of America

# Mylan/Perrigo

- FTC challenges by stage of product development
  - Allergan/Inamed (2006)
    - Inamed ordered to divest its rights to clinical trials for the cosmetic botulinum toxin product Reloxin, which was in Phase III clinical trials
  - Sanofi/ Aventis (2004)
    - Aventis was ordered to divest its rights to clinical trials for the drug Camptosar, which included a study for treatment of metastatic gastric cancer which was in Phase II/ Phase III of development
  - Cephalon, Inc./CIMA labs (2004)
    - Cephalon was ordered to divest Actiq, a cancer pain drug, in Phase III of clinical testing
  - Glaxo Wellcome/SmithKline Beecham (2001)
    - Glaxo was ordered to divest its rights in DISC-HSV Prophylactic Vaccines, which included a prophylactic herpes vaccine in Phase III clinical trials

# Medtronic/Covidien



**Medtronic**  
*When Life Depends on Medical Technology*



**COVIDIEN**



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# Medtronic/Covidien

## ■ The deal

- Medtronic to acquire Covidien for \$42.9 billion
  - Announced June 15, 2014
  - 29% premium to Covidien's closing stock price the day before announcement
  - Expect \$850 million in annual pretax cost synergies
  - Medtronic commits \$10 billion in additional U.S. technology investments over 10 years

## ■ Medtronic

- Global medical technology and services company

## ■ Covidien

- Global healthcare products company

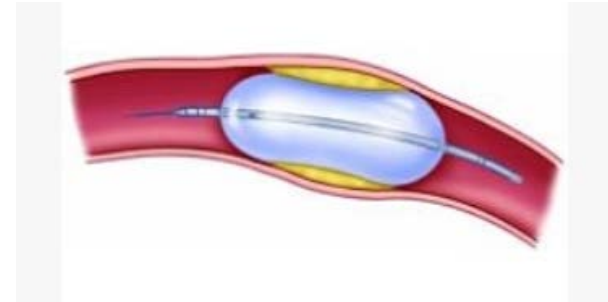
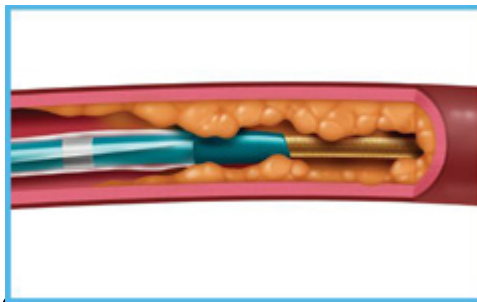
## ■ Combined company

- Combined revenue: \$27 billion
- 87,000 employees in more than 150 countries

# Medtronic/Covidien

## ■ The FTC concern

- C.R. Bard is the only company manufacturing and selling drug-coated balloon catheters
  - Used primarily to treat peripheral artery disease, a narrowing of the peripheral arteries to the legs, stomach, arms, and head
- Medtronic and Covidien are developing drug-coated balloon catheters for the fem-pop artery to compete with Bard
  - Only companies with products in clinical trials in the FDA approval process



## ■ Consent decree

- Medtronic to sell Covidien's rights and assets related to Covidien's drug-coated balloon catheters business to Spectranetics
  - Spectranetics is a leader in peripheral vascular solutions with a portfolio of products that is highly complementary to Covidien's drug-coated balloon catheter

# Mallinckrodt/Novartis AG



# Mallinckrodt/Novartis AG

## ■ Background

- Questcor's H.P. Acthar Gel is the only therapeutic adrenocorticotrophic hormone (“ACTH”) product sold in the United States
  - ACTH is the standard of care for infantile spasms (“IS”), a rare but extremely serious disorder involving seizures within the first two years of life
  - Questor acquired the rights to Acthar in 2001
  - Since 2001, Questcor has repeatedly raised Acthar’s price from \$40 per vial in 2001 to more than \$34,000 per vial today
  - A course of Acthar treatment for IS requires multiple vials and can cost well over \$100,000

## ■ The deal

- In June 2013, Questcor acquired the rights to sell Synacthen Depot in the United States from Novartis
  - On August 14, 2014, Mallinckrodt plc acquired Questor Pharmaceuticals for \$5.8 billion
  - At that time, Acthar was the only drug product sold by Questcor

# Mallinckrodt/Novartis AG

- The FTC concern
  - Synacthen is a synthetic ACTH drug sold in order parts of the world to treat IS
    - In 2011, Novartis decided to sell the exclusive rights to seek FDA approval for Synacthen and commercialize it in the United States
    - Three firms submitted formal offers to Novartis
  - In 2013, Questcor entered the bidding and outbid other companies to acquire the U.S. rights to Synacthen for a minimum royalty of \$135 million and a likely payment of \$300 million
  - *Allegation*: Questcor acquired the Synacthen rights to prevent another company from entering into competition with Acthar

# Mallinckrodt/Novartis AG

## ■ The challenge

- Complaint filed January 18, 2017 (post-acquisition)
- Action brought in federal district court by FTC and five states
- Questcor's acquisition of the Synacthen rights violated—
  - Section 2 of the Sherman Act (monopolization)
  - Section 5 of the FTC Act
  - Various state statutes

## ■ Outcome

- Mallinckrodt settled and stipulated to the entry of a permanent injunction:
  - No actual litigation—Stipulation filed simultaneously with the complaint
  - Pay \$100 million
  - Grant a license to develop Synacthen to treat infantile spasms and nephrotic syndrome to an FTC-approved licensee within 120 days of the entry of the order
  - Pay \$2 million to states for attorney's fees and costs
  - Monitor to oversee compliance

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# Steris/Synergy Health



# Steris/Synergy Health

## ■ The deal

- Steris to acquire SynergyHealth for \$1.9 billion
  - Announced October 13, 2014

## ■ Steris

- Second largest sterilization company in the world (2014 revenues: \$604 million)
- Largest provider of gamma radiation sterilization services in the United States with 12 facilities
- Also has 10 ethylene oxide ("EO") gas sterilization facilities

## ■ SynergyHealth

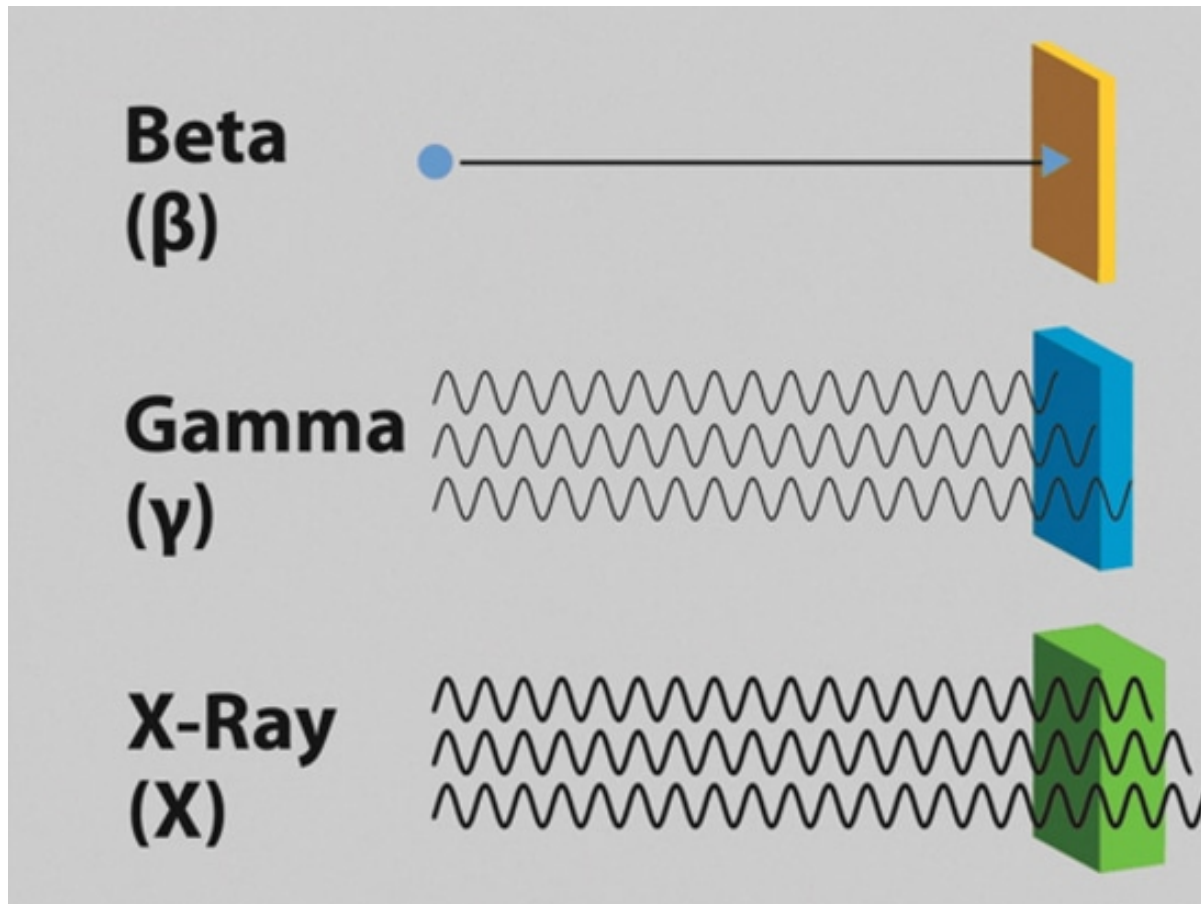
- Third largest sterilization company in the world
- Operates more than 36 contract sterilization facilities outside of the United States
  - Primarily gamma radiation facilities
  - Daniken, Switzerland—a gamma ray/x-ray facility
    - Only facility in the world providing x-ray sterilization services on a commercial scale
- Currently offers only e-beam and EO sterilization services in the United States



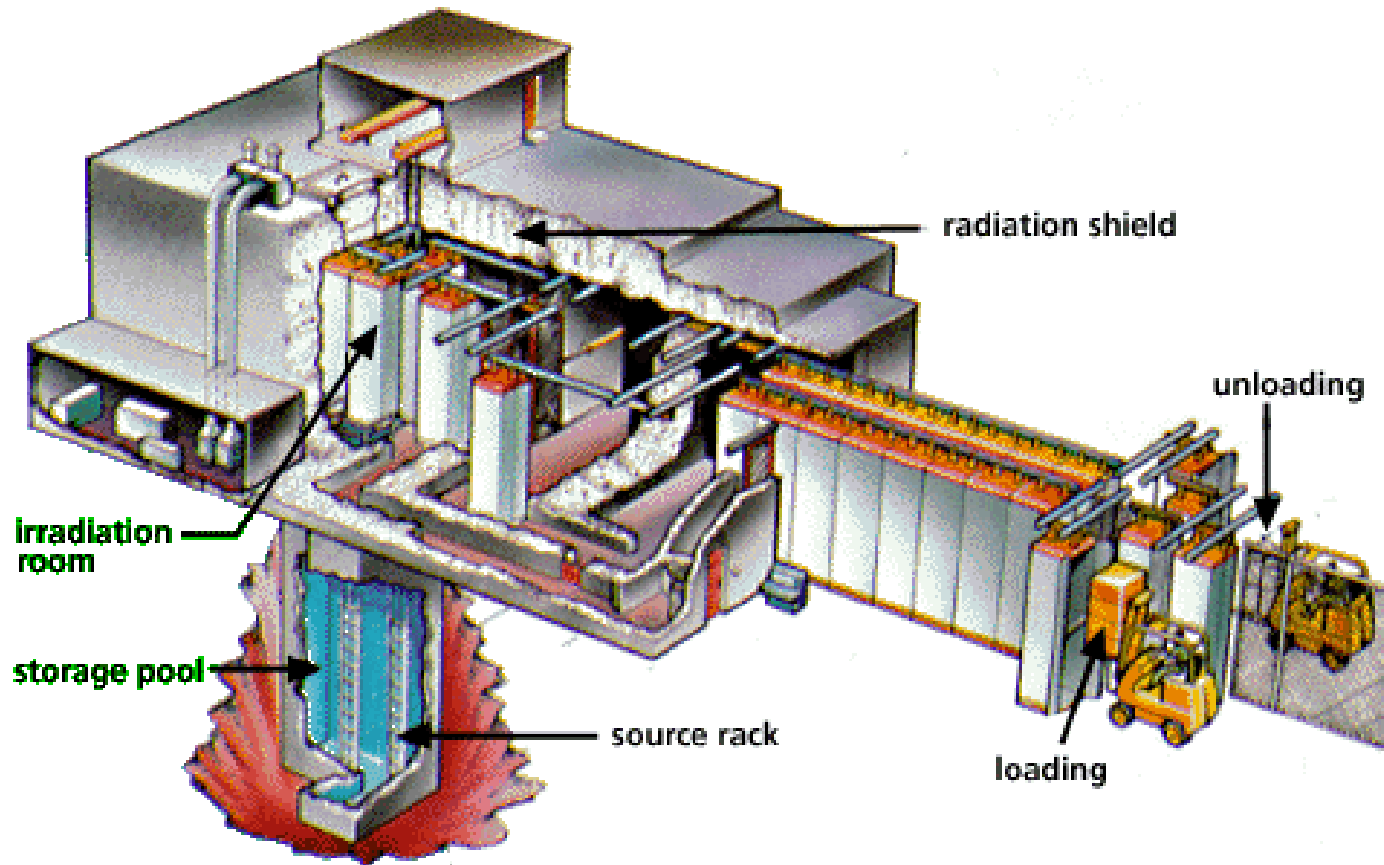
# Steris/Synergy Health

- The FTC concern
  - There are only two gamma radiation sterilization providers in the United States:
    - Sterigenics (14 facilities)
    - Steris (12 facilities)
  - *Allegation:* Absent the acquisition, SynergyHealth would have entered the U.S. with a new x-ray sterilization facility
    - According to the FTC, x-ray sterilization is a competitive alternative to gamma sterilization because it has comparable, “and possibly superior,” depth of penetration and turnaround times
  - *Claim:* Steris’s acquisition of SynergyHealth insulated Steris from SH’s potential competition from x-ray sterilization to Steris’ gamma sterilization

# Steris/Synergy Health



# Steris/Synergy Health



# Steris/Synergy (2015)

- District court
  - Following a three-day evidentiary hearing, the court denied the preliminary injunction
  - Assumed the elimination of actual potential competition is a cognizable theory
    - Highly concentrated market
    - Alleged potential entrant “probably” would have entered the market
    - Such entry would have had procompetitive effects
    - Few if any other firms could enter the enter effectively<sup>2</sup>
  - *Court*: The FTC failed to show that Synergy would have entered the U.S. but for the transaction.

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<sup>1</sup> These are the elements as stated by the FTC in its supporting papers. Most case law supports a more demanding test on the likelihood of entry by the potential entrant and on the likelihood of entry by other firms in the absence of entry by the potential entrant.

# Nielsen/Arbitron (2012)

## ■ Transaction

- Nielsen to acquire Arbitron for \$1.26 billion (26% premium)
- Combined company: About \$6.0 billion in revenue

## ■ Parties

- Nielsen: Essentially a monopolist in television audience measurement services
- Arbitron: Essentially a monopolist in radio audience measurement services

## ■ Cross-platform audience measurement services

- Both Nielsen (on its own) and Arbitron (through a jv with comScore) were separately developing a service for measuring frequency of unduplicated audience exposure for programming content and advertising across platforms (television, radio, PC, smartphones, tablets)
- Entry requires a broad-based national audience television panel of known demographics and audience measurement technology
- Only Nielsen and Arbitron have such panels and audience measurement technology
- They are very expensive to create and there was no evidence that anyone would create a new one postmerger

# Nielsen/Arbitron (2012)

## ■ FTC concern

- Elimination of actual potential competition
  - In the absence of the transaction, Nielsen and Arbitron likely would have developed competing cross-platform audience measurement services
  - With transaction, companies will develop only one service
  - No other company—or consortium of companies—appears likely to enter into the development of such a service postmerger

## ■ FTC consent decree

- *Principle*: Enable another company to replicate Arbitron's participation in the comScore JV.
- Requirements
  - Sell Arbitron's Link Meter Technology to an approved divestiture buyer (no buyer upfront)
  - License use of calibration panel, television data, radio data, and calibration panel data for 8 years
  - Provide technical assistance at cost
  - Remove all barriers to hiring key Arbitron personnel
  - Provides for a compliance monitor
  - Permits FTC to appoint a divestiture trustee to sell assets and license technology and data if Nielsen fails to do so within the time limits of the consent decree (3 months)

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# Nielsen/Arbitron (2012)

- Not addressed by the FTC
  - Lessening of innovation incentive
    - Nielsen was perceived by some industry participants as uninterested in innovation and as suppressing the R&D activity of companies it acquired
    - Arbitron was perceived by some industry participants as a more innovative company
    - Industry concern: The rate of Arbitron innovation postmerger would be suppressed
- Final resolution
  - FTC approved comScore to be the divestiture buyer

# Akorn/VersaPharm (2014)

- Transaction
  - Akorn to acquire VersaPharm for \$324 million
- Parties
  - Akorn: A niche pharmaceutical company with 2013 revenues of \$318 million
  - VersaPharm: Niche company offering 20 generic products with a pipeline of another 20 products
- Injectable Rifampin
  - Tuberculosis drug—No substitutes
  - Only VersaPharm and two other firms currently have FDA approval
- FTC concern
  - In the absence of the transaction, Akorn likely would have entered the market
- FTC consent decree
  - Divest Akorn Abbreviated New Drug Application (ANDA) to Watson Laboratories (buyer upfront)
  - Provide Watson with any information the FDA requests and assist Watson in obtaining FDA approval for ANDA