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# Innovation in the context of merger review

*A new theory of harm?*

Hiram Andrews, 26 October 2017

# Potential Competition vs. Innovation Competition

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## Nothing new about examining “potential competition” issues

- The US Federal Trade Commission (FTC) and US Department of Justice (DOJ) often have focused on potential competition issues:
  - Current competitors vs. recent or potential entrants
  - Marketed vs. pipeline product overlaps
  - Pipeline vs. pipeline product overlaps

## Concept of “innovation competition”

- In some instances, the FTC and DOJ have examined whether a transaction will affect incentives for innovation generally
- However, it is difficult to find examples of the US agencies seeking to block a transaction or seek specific remedies based solely on a theory that a transaction will result in a general reduction in incentives for innovation
- The US agencies sometimes may allege that a transaction will reduce incentives to innovate, but this typically is done only when they also identify specific product overlaps and in connection with those overlaps

# U.S. Horizontal Merger Guidelines

## Horizontal Merger Guidelines



U.S. Department of Justice  
and the  
Federal Trade Commission

Issued: August 19,

### 6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

# Potential competition: Verisk/EagleView

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## Current competitor vs. recent entrant

- In 2014, the FTC challenged Verisk Analytics, Inc.'s proposed acquisition of EagleView Technology Corporation, alleging that it likely would reduce competition and result in a virtual monopoly in the U.S. market for rooftop aerial measurement products used by the insurance industry to assess property claims
- Acquisition of an innovative, new entrant by the dominant player in the market prompted FTC to challenge the transaction

- FTC Statement:

*EagleView is the dominant company and Verisk is the only meaningful competitor offering rooftop aerial measurement products to insurance carriers. Verisk's entry into the market has provided a lower-priced alternative to customers. If this transaction goes through, insurance carriers, and ultimately consumers, face the risk of higher prices.*

- Parties abandoned the transaction following the FTC challenge



# Potential competition: Steris/Synergy

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## Current competitor vs. potential entrant

- In 2015, the FTC challenged Steris Corporation's proposed acquisition of Synergy Health plc would violate the antitrust laws by significantly reducing future competition in regional markets for sterilization of products using radiation, particularly gamma or x-ray radiation
- Although Steris and Synergy were not current competitors in the relevant market, FTC alleged that Synergy was in the process of implementing a strategy to begin competing with Steris in the US
- FTC Statement:

*The Commission alleges that the challenged acquisition would eliminate likely future competition between Steris's gamma sterilization facilities and Synergy's planned x-ray sterilization facilities in the United States, thus depriving customers of an alternative sterilization service and additional competition.*
- District Judge dismissed motion to enjoin the transaction, concluding that Synergy had decided not to enter the market in the US and therefore would not be a future competitor of Steris

# Potential competition: Genzyme/Novazyme

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## Pipeline vs. pipeline product overlap (preclinical)

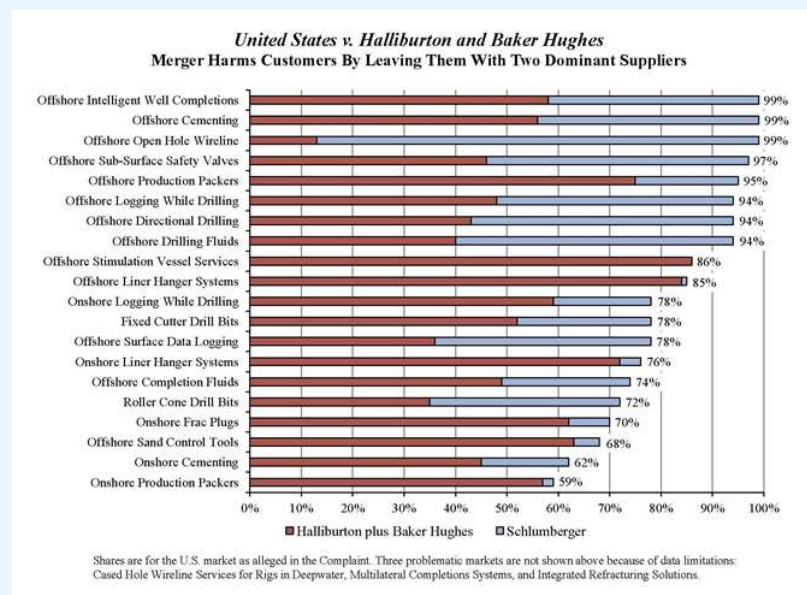
- In 2004, the FTC examined closely Genzyme Corporation's acquisition of Novazyme Pharmaceuticals, Inc.
  - At the time of its acquisition, Novazyme was engaged primarily in conducting early preclinical studies relating to enzyme-replacement treatment (ERT) for Pompe disease
  - Genzyme was also engaged in preclinical animal testing of ERTs
- Key question of whether the acquisition led to a reduction in incentives to innovate
- FTC ultimately did not challenge the acquisition, with Chairman Tim Muris concluding that:

*The Commission's investigation properly focused on how the transaction would affect the pace and scope of research into pharmaceutical products for a life-threatening medical condition affecting infants and young children for which no treatment presently exists. The facts of this matter do not support a finding of any possible anticompetitive harm. Moreover, on balance, rather than put patients at risk through diminished competition, the merger more likely created benefits that will save patients' lives*

# Innovation competition: Halliburton/Baker Hughes

## Product overlaps and reduced innovation

- In 2016, the DOJ challenged Halliburton Company's proposed acquisition of Baker Hughes, Inc., alleging that the transaction would eliminate competition, raise prices, and reduce innovation in the oilfield services industry
- DOJ argued that the transaction would combine two of the three largest oilfield services companies in the United States and the world, eliminating important head-to-head competition in markets for 23 products or services used for on- and off-shore oil exploration and production in the United States
- DOJ identified "reduced innovation" as one of the reasons the transaction would be anticompetitive, but focused primarily on specific product overlaps
- Parties abandoned transaction after DOJ announced it would seek to block it in court



# Innovation competition: DOJ review of Dow/DuPont

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## DOJ decided not to seek remedies to address innovation competition concerns raised by the European Commission

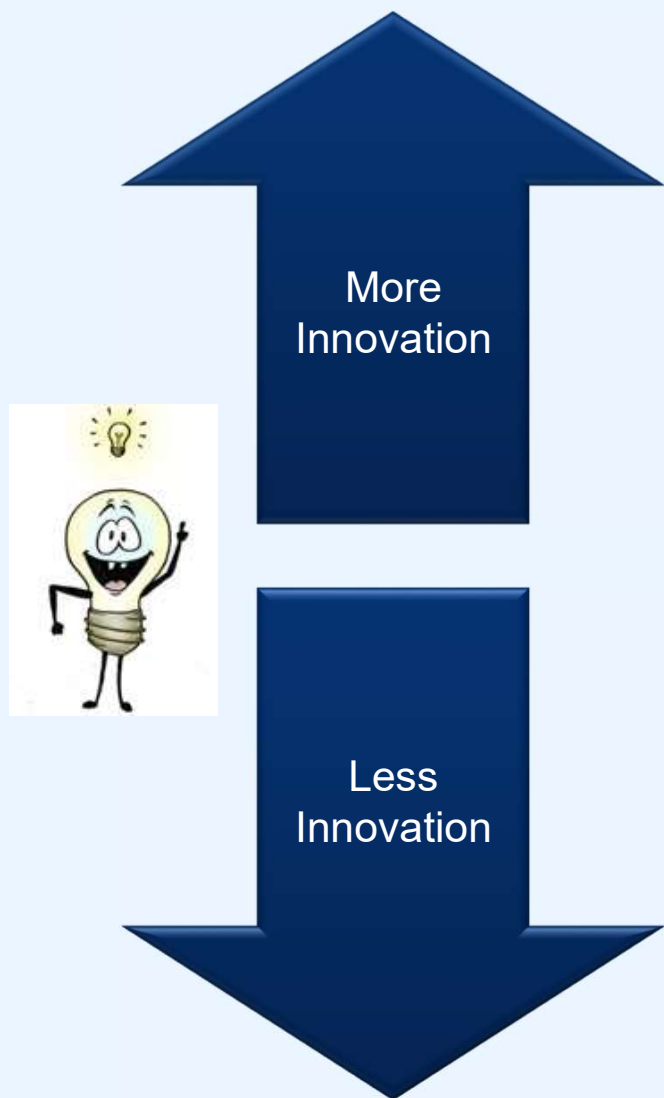
- In June 2017, DOJ required The Dow Chemical Company (Dow) and E.I. DuPont de Nemours & Co. (DuPont) to divest multiple crop protection and two petrochemical products in order for the parties to proceed with the transaction
- DOJ alleged that the transaction likely would reduce competition between two of only a handful of chemical companies that manufacture certain types of crop protection chemicals and the only two US producers of acid copolymers and ionomers, potentially harming US farmers and consumers
- DOJ noted in its press release:

*Like the European Commission, the Antitrust Division examined the effect of the merger on development of new crop protection chemicals but, in the context of this investigation, the market conditions in the United States did not provide a basis for a similar conclusion at this time*
- Unclear how the market conditions in the US differed from those in Europe



# Does consolidation reduce innovation?

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- Fewer competitors results in decreased risk of duplicative innovation (appropriability)
- Complementary innovation efforts
- Increased resources and ability to bring products to market effectively

- Increased risk of cannibalization of existing products
- Substitutable innovation efforts
- Drive to realize efficiencies associated with transaction may result in lower R&D spend

# Whether antitrust authorities should intervene

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- What should antitrust authorities do when it is unclear whether the transaction will lead to increased or decreased incentives to innovate?
- Key considerations when reviewing mergers, particularly when examining potential effects in innovation competition markets
  - Challenge of predicting the future
  - Lack of clear consensus among economists
  - Whether the divestiture of an R&D division will be successful
  - Risk of preventing realization of procompetitive benefits
  - Importance of identifying all potential innovators
  - Role of underlying procedural considerations



# Thank you

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**Hiram Andrews**

Counsel

T +1 212 284 4950

E [hiram.andrews@freshfields.com](mailto:hiram.andrews@freshfields.com)

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