Class 16 slides

Unit 10: U.S. Sugar/Imperial Sugar

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U.S. SUGAR

SINCE 1843

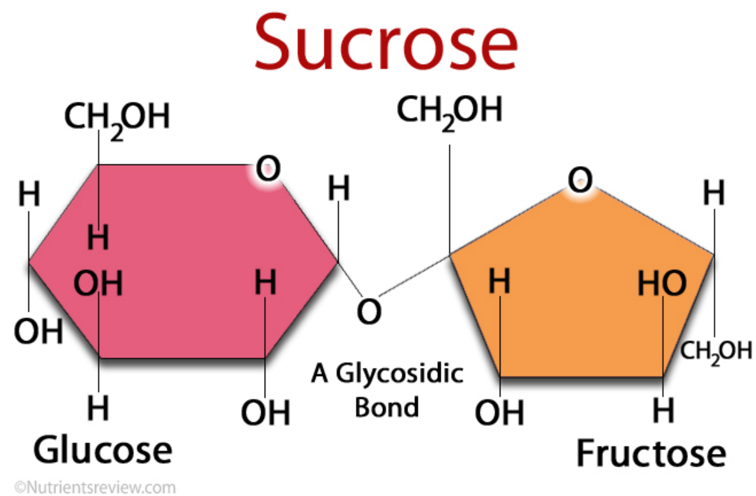
Imperial Sugar

The Sugar Industry

The sugar industry

- Refined sugar
  - Food-grade sugar that is produced by refining sugar cane or processing sugar beets into sucrose (a combination of glucose and fructose)
  - Refined sugar produced from sugar beets is chemically identical to that produced from sugar cane
  - Types:
    - Granulated (99.5% sucrose—white in color)
    - Brown
    - Powdered
    - Liquid

Brown, Powdered, Liquid: Produced from additional processing of granulated sugar



Sugar production from sugar cane

Sugar cane

- Perennial grass containing about 14% sucrose
- Grown in Florida (51.9%), Louisiana (44.6%), and Texas (3.5%)
- Not imported—Value-to-weight ratio too high

Raw sugar

- Partially refined sugar processed from sugar cane
- Sugar mills close to the sugar cane plantations crush the cane and extract/partially refine sugar
- Primarily sucrose (96-99%) with some natural molasses
- Light brown in color
- Relatively inexpensive to transport
- Significant imports
- Can be consumed

Refined sugar

- Fully refined sugar processed from raw sugar
- Types:
  - Granulated (99.5% sucrose -- white in color)
  - Brown, powdered, liquid—produced from granulated
- Significant imports

Sugar production from sugar beets

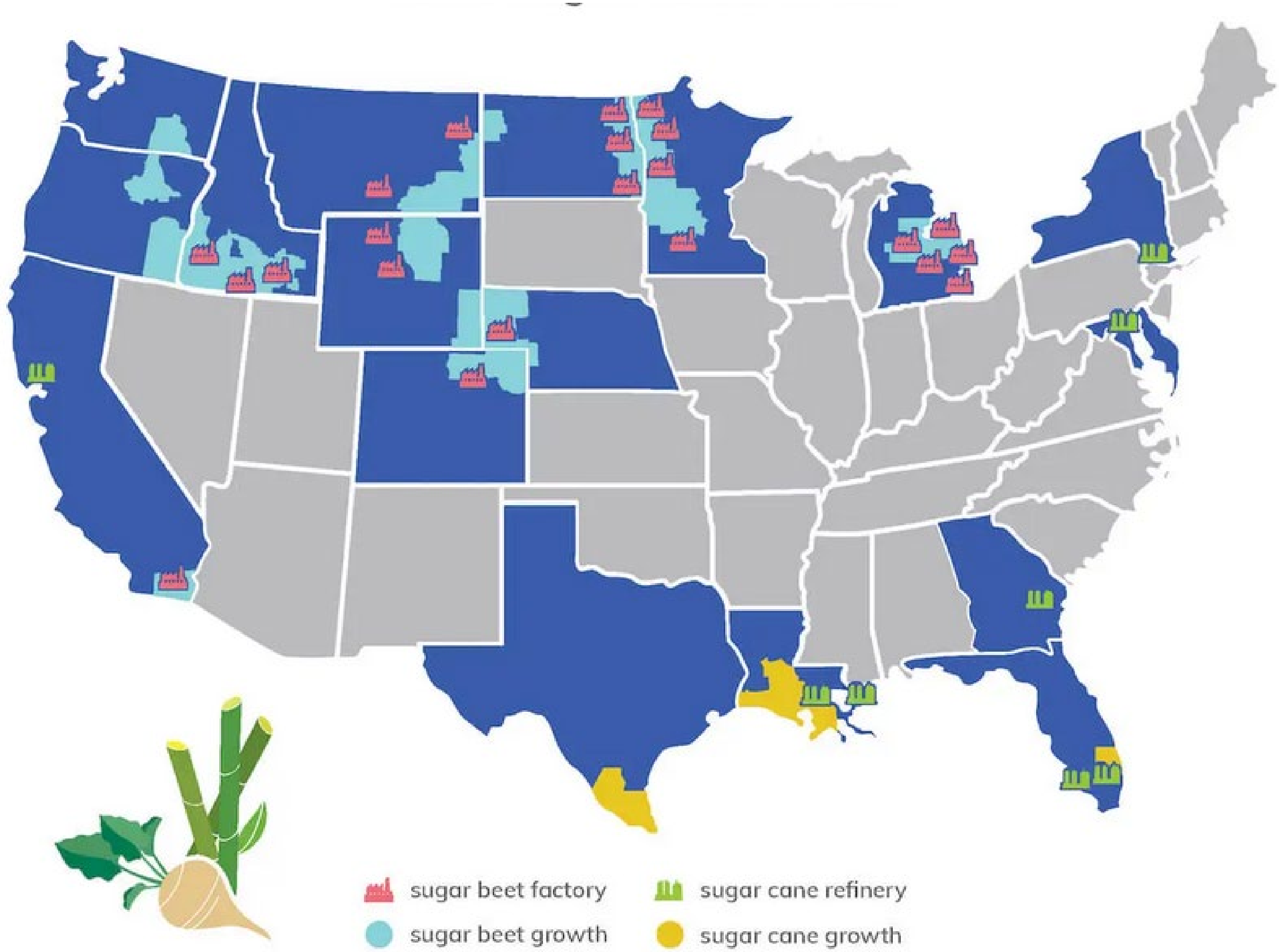
Sugar beets

- Root crop containing about 16% sucrose
- Grown in eleven states: California, Colorado, Idaho, Michigan, Minnesota, Montana, Nebraska, North Dakota, Oregon, Washington, and Wyoming

Refined sugar

- Fully refined sugar directly from sugar beets
- Chemically identical to sugar produced from sugar cane
- 99.5% sucrose (0.5% water)
- Seven U.S. sugar refiners
- White in color (without additives)
- Significant imports

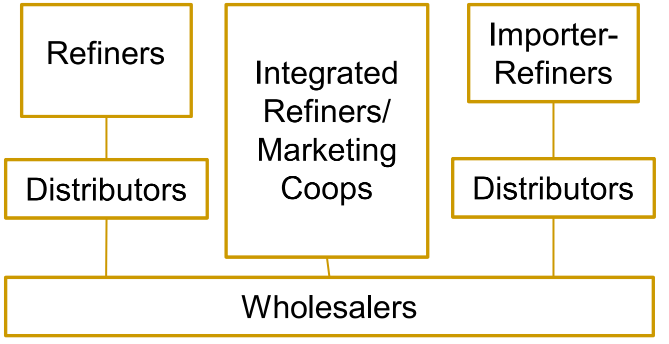
U.S. sugar production



Source: The Sugar Ass'n, U.S. Sugar Industry

Industry organization

- Production, distribution, and sale



- Distributors (including marketing coops)
  - Purchase refined sugar from refiners or importers
  - May repackage it or further process it into liquid, invert, brown, or powdered sugar
  - May offer nationwide shipping using rail transfer stations and their own trucking fleets
- Wholesaler purchasers
  - Most purchases done through a "Request for Proposal" (RFP)
    - Most RFPs are for delivered prices
  - Essentially, suppliers bid for wholesaler business through their responses to the RFPs

USDA Federal Sugar Program

- Sugar supply is largely regulated by the USDA

> The Federal Sugar Program, as run by the USDA, purports to balance somewhat competing government policies that impact the price of sugar - i.e., the Government's support of American sugar cane and sugar beet farmers by ensuring that there is a guaranteed floor price to be able to stay in business and the Government's interest in ensuring that sugar prices do not get too high for the many businesses (known as sugar "users") that buy sugar to use in their products.[1]

- The USDA controls the supply of sugar in the United States through—
  1. Marketing allotments for domestic sugar processors
     - Individually set for each processor
     - Caps the amount of sugar the processor is allowed to sell
  2. A system of tariff rate quotas (TRQs) on sugar imports and free trade agreements
     - Imports under the quota are charged a discounted duty rate
     - Imports over the quota are charged the full duty rate—essentially makes these imports unviable
     - → TRQ imports effectively constrain domestic prices
  3. Control over Mexican imports under the U.S. Mexico Suspension Agreements
  4. Since 2007, USDA has taken at least 30 actions to increase foreign sugar imports into the U.S. when it believed that additional supply was necessary

[1] Op. at 16.

The Deal

The deal

- U.S. Sugar to buy Imperial Sugar
  - Merger Agreement signed March 24, 2021
  - Purchase price: $315 million
    - Later reduced to $297 million
  - Asset purchase—Buying only assets, not stock
    - Imperial’s Port Wentworth facility
    - Imperial’s leasehold interest in a sugar transfer and liquification facility in Ludlow, KY
    - Four retail sugar brands:
      - Imperial Sugar
      - Dixie Crystals
      - White gold
      - Holly Sugar
  - Drop-dead date: September 24, 2022

The parties

- U.S. Sugar
  - Privately held Delaware corporation headquartered in Clewiston, FL
  - Owns and operates a cane mill and cane refinery in Clewiston
    - Refinery capacity: 850,000 tons annually—operates at maximum capacity
    - Produces only granulated and liquid sugar
      - Not brown or powdered sugar
    - Less than 7% nationwide refined sugar capacity
  - Vertically integrated in sugar cane growing
    - Plantations in South-Central Florida (200,000 acres)
    - Grows more sugar than U.S. Sugar can process
    - So sells sugar cane to third-party mills in Florida
  - Vertically integrated into distribution
    - USG owns United Sugars Corporation ("United") with three other sugar producers
      - United States Sugar (cane sugar)
      - American Crystal Sugar Company (beet sugar)
      - Minn-Dak Farmers Cooperative (beet sugar)
      - Wyoming Sugar Company, LLC (beet sugar)
    - United is a marketing cooperative that controls the pricing, marketing, and sale of all the sugar of its four members[1]
      - Sells sugar in 45 states

[1] Presumably, United is immune from the antitrust laws as an agricultural cooperative under the Capper-Volstead Act, 7 U.S.C. § 291.

The parties

- Imperial Sugar
  - Headquartered in Sugar Land, TX
    - Wholly-owned by Louis Dreyfus, a leading worldwide merchant and processor of agricultural goods headquartered in the Netherlands
  - Owns and operates cane sugar refinery in Port Wentworth, GA
    - Imperial Sugar’s principal asset
      - Experienced a major explosion in 2008 that destroyed the plant—damaged part rebuilt in 2009
    - Capacity: _______
    - Produces granulated, brown, powdered, and liquid sugar
    - Sells refined sugar into more than 40 states, including Texas, Indiana, Pennsylvania, and Ohio out of Port Wentworth
  - Does not own any cane farming or milling assets—imports > 90% of raw sugar

Imperial’s Port Wentworth sugar refinery

After 2008 explosion

Today

Deal benefits[1]

- Imperial's Port Wentworth current operations
  - Input supply limitations
    - Import-based refiner—imports > 90% of its raw sugar
    - Still, can only run at about 75% of capacity due to lack of supply (sometimes only 60-65%)
    - Accounts for about 7% of nationwide sugar refining capacity
  - Input cost limitations
    - Raw sugar comprises about 70-80% of the delivered price of Imperial's refined sugar
    - Has higher input costs than refineries vertically integrated into sugar cane or sugar beets
  - Investment limitations
    - High-cost producer dependent on imports subject to tariffs
    - Some equipment from the 1940s
    - Uncertain financial future
    - Louis Dreyfus has limited investment to maintenance and safety/health/environmental
  - Market position
    - Declining over the last several years
    - Principally a residual or back-up supplier
  - Prospects of sale
    - Louis Dreyfus has been trying to sell Imperial for the last five years

[1] Taken from findings of fact in the opinion. Op. at 22-23.

Deal benefits

- Benefits of acquisition
  - Mitigation of input supply limitations
    - U.S. Sugar grows more sugar cane than it can process and refine
    - U.S. Sugar will be able to provide between 84,000-168,000 short tons annually to Port Wentworth
  - Production expansion
    - U.S. Sugar plans to expand Port Wentworth's annual production from 805,000 short tons to 875,000 short tons, an increase of 70,000 short tons or 8.7%[1]
    - U.S. Sugar will use "targeted expenditures" to increase the capacity utilization at Port Wentworth
  - Transportation cost savings
    - Adding Port Wentworth to the United distribution network expected to save $8-12 million (annually?)
  - Reliability of supply
    - Adding Port Wentworth to the United distribution network will increase reliability of supply to
      - Premerger Port Wentworth customers,
      - U.S. Sugar/United customers in the event of an adverse weather event in the Red River Valley or in Florida
  - Port Wentworth's future absent the acquisition
    - "If the U.S. Sugar acquisition does not proceed, Imperial's CEO is 'quite worried' about Imperial's future prospects."

[1] The opinion gives the difference as 140 million pounds. Op. at 22. Some conversions are necessary. The opinion gives the before and after numbers in cwt (hundredweight, short, US), which equals 0.5 short tons. Converting cwt to short tons, the before and after production levels are 805,000 and 875,000, respectively (as given in the text), for a difference of 70,000 short tons. But each short ton equals 2000 pounds, so 70,000 short tons equals 140 million pounds.

DOJ complaint

- *Filed*: November 23, 2021
  - Seven months after the signing of the merger agreement
- *Claim*:
  - Acquisition would substantially lessen competition—
    - in the production and sale of refined sugar
    - to wholesale customers
    - In—
      1. the Southeastern United States, *and*
      2. Georgia

Relevant product market

Targeted customers

Relevant geographic markets

- *Prayer*: Permanent injunctive relief blocking the transaction

DOJ complaint

- A note on the DOJ's prima facie case of anticompetitive effect
  - The *PNB* presumption: Transaction treated largely as a 3-to-2 merger with a fringe[1]
    - Southeastern United States
      - Combined share: 46%
      - Delta: 800
      - Postmerger HHI: 2800
      - Postmerger 2FCR: 75%
    - Georgia
      - Combined share: 54%
      - Delta: 1100
      - Postmerger HHI: 3100
      - Postmerger 2FCR: 75%

From DOJ Post-Trial Brief

From DOJ Post-Trial Brief

[1] The third major player in the alleged markets was American Sugar Refining Company (ASR), also known as Domino Sugar. ASR has two cane sugar refineries: Chalmette, Louisiana, which sells in 44 states, and Okeelanta, Florida, which sales in ___ states [redacted in opinion].

DOJ complaint

- A note on the DOJ's prima facie case of anticompetitive effect
  - A trick in deconstructing market share
    - In many opinions, the market shares of the merging parties are redacted
    - However, the opinion may report the combined market share and the associated HHI
    - Let *a* and *b* be the market shares of the merging companies
    - Then:

$$a + b = \text{combined share}$$
$$2ab = \text{delta}$$

    - These are two simultaneous equations in two unknowns, so you can solve for *a* and *b*
    - If you like, use a simultaneous equations calculator like Symbolab
  - Here:

			Solving:
Southeastern United States			
Combined share:	46%	$a + b = 46\%$	$a = 37.7\%$
Delta	800	$2ab = 800$	$b = 11.4\%$
Georgia			
Combined share:	54%	$a + b = 54$	$a = 40.7\%$
Delta:	1100	$2ab = 1100$	$b = 13.4\%$

DOJ complaint

- A note on the DOJ's prima facie case of anticompetitive effect
  - Dimensions of anticompetitive harm
    - Price
    - (Throwaway:) Reliability of supply
  - Auction unilateral effects
    - "The proposed transaction would eliminate head-to-head competition between United and Imperial in both relevant markets."
    - The idea
      - United and Imperial are the two lowest cost suppliers for some customers and the acquisition will eliminate their independence
      - Competition for these customers will be between the combined firm and the third-lowest-cost supplier, resulting in an anticompetitively higher winning bid price[1]

[1] We will develop this bidding theory of unilateral effects in the next class when we study Sysco/U.S. Foods.

DOJ complaint

- A note on the DOJ's prima facie case of anticompetitive effect
  - Coordinated effects

> "The proposed transaction would increase the incentive and ability of industry giants United and Domino to coordinate to raise prices and reduce quality."

- Premerger susceptibility
  - Refined sugar is a relatively homogeneous product
  - Sugars prices "relatively transparent" (from customers)/Competitors monitor each other's prices
  - Competitors can readily identify incumbent suppliers for each customer—makes it easy for coordinating firms from "poaching" each other's customers
  - Only three significant competitors in the two markets: USS/United, Domino, and Imperial
  - High barriers to entry/expansion
- Increased likelihood or effectiveness
  - Only two significant competitors would remain postmerger: USS/United and Domino
  - Transaction mores closely aligns the incentives of USS/United and Domino by increasing homogeneity across firms
    - Factors:
      - Domino is a large vertically integrated firm that imports some raw sugar
      - USS is somewhat smaller and imports no sugar/Imperial purchases some imported raw sugar
    - Creates more similarly sized firms
    - Creates a similar level of vertical integration [WDC: ???]

DOJ complaint

- A note on DOJ's response to anticipated downward pricing pressure defenses
  - Entry/expansion defense

    "Entry and expansion will not prevent the substantial harm threatened by this deal"

    - High barriers to building or expanding a refinery
    - High transportation costs limit the ability of outside refiners to increase shipments into the relevant markets
  - Efficiencies defense

    "There are no merger-specific efficiencies that outweigh the substantial harm threatened by this deal"

[1] Complaint ¶ 57.

DOJ complaint

- A note on the USDA Federal Sugar Program

> "USDA's sugar policy will not prevent the substantial harm threatened by this deal"

  - USDA does not run its programs to ensure competition in the sale of refined sugar to wholesalers
  - USDA programs permits "significant regional variations in the prices charged to customers due to differences in competitive conditions in each area"[1]

[1] Complaint ¶ 57.

DOJ complaint

- Request for relief
  1. Declaration that the acquisition would violate Section 7
  2. Permanently enjoining defendants from consummating the acquisition
  3. Award the United States the costs of its action
  4. Grant the United States such other relief as the Court deems just and proper

The trial

- Venue
  - Filed November 23, 2021
  - In the District of Delaware
- Judge Maryellen Noreika
  - Nominated by President Donald Trump
  - Sworn in: August 9, 2018
  - Reportedly considered by President Biden for the Federal Circuit
- Trial
  - Parties stipulated to a TRO—proceeded to trial on the merits
    - Court consolidated proceedings under Rule 65(a)(2)
  - Trial began on April 18, 2022 (four days)—5 months after the complaint was filed
    - 30 fact witnesses/2 expert witnesses
    - Exhibits: 24 (joint), 74 (plaintiffs), 31 (defendants)
  - Decision: Permanent injunction denied on Sept. 23, 2022
    - 9 months after complaint filed
  - Currently on appeal

Experts

- DOJ: Dr. Dov Rothman
  - Managing principal at Analysis Group
  - Ph.D in business administration from the Haas School of Business, University of California, Berkeley
  - Joined Analysis Group in 2006
  - 2004-2006: Assistant Professor,
    Mailman School of Public Health, Columbia University
  - Testified in multiple antitrust cases
    - Including four merger cases for the government

- Merging parties: Dr. Nicholas Hill
  - Partner at Bates-White
  - Ph.D in economics, Johns Hopkins University
  - Joined Bates-white in 2017
  - Prior 12 years as a government antitrust economist
    - 2014-2017: ATD Assistant section chief
    - 2013-2014: FTC staff economist
    - 2006-2013: ATD staff economist
  - Testified in several antitrust cases