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MERGERS AND ACQUISITIONS

Chemicals Mergers: Do Recent Blocked Deals Signal Rough Seas Ahead?

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I. Introduction

What is behind the recent parade of blockbuster deals blocked or abandoned because of regulatory concern that a deal will harm competition? Much of the time, it comes down to whether or not the regulators believe that the transaction offers enough efficiencies and consumer benefit to outweigh any potential competitive harm. Indeed, the intense regulatory scrutiny of strategic M&A transactions that has caused deal after deal to fail is often related to the parties' ability to prove the procompetitive benefits of the proposed transaction. Today, U.S. antitrust enforcers are not easily swayed by unquantified efficiencies, and some deals have little hope of obtaining antitrust clearance from the Federal Trade Commission (FTC) or Department of Justice (DOJ). But even in mergers where there are some real, nontrivial efficiencies, the current regulatory climate is most focused on merger-specificity and total impact on consumers when evaluating mergers. Recently, chemical companies Superior Plus ("Superior") and Canexus abandoned a deal worth over $900 million after an FTC challenge that alleged the deal provided no significant efficiencies. Should the Superior deal's fate worry the many chemical companies seeking to merge in a wave of consolidation in the industry?

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II. Background – The companies and the deal

To answer that question, we first need to take a closer look at the merger itself. The two companies, Superior Plus and Canexus, sought to merge in a deal valued at $982 million. Superior Plus has a specialty chemicals division (ERCO) with nine chemicals plants (six in Canada, two in the United States and one in Chile[2]), an energy services division that distributes propane and other refined fuels, and a construction products distribution business. Canexus is a specialty chemicals company that owns seven chemical plants, five in Canada and two in Brazil.

[2] SuperiorPlus website, http://www.superiorplus.com/Superior-Plus-Businesses-Specialty-Chemicals-Website.php

Superior Plus's plants produce the specialty chemicals caustic soda (sodium hydroxide), chlorine, hydrochloric acid, potassium hydroxide, sodium chlorate, and sodium chlorite. In addition, they have a technology services division that offers installation of and training in the equipment pulp mills need to prepare and use the bleach chemicals they sell, like sodium chlorate. Canexus produces the chemicals caustic soda, chlorine, hydrochloric acid, and sodium chlorate.

The greatest overlap in the companies' business, and the focus of the FTC's antitrust complaint, is in the production of sodium chlorate, a chemical used to create the bleaching agent chlorine dioxide, used primarily in the manufacturing of paper products. About 95% of sodium chlorate produced in North America is sold to the pulp and paper industry.[3] Together, the combined Superior Plus/Canexus entity would have controlled about 50 percent of the North American market for sodium chlorate, and the combined entity together with its next-largest competitor AkzoNobel would have controlled 80% of North America's total sodium chlorate production capacity.[4]

III. Regulatory Reactions

Superior Plus announced the deal on October 6, 2015.[5] In talks with the FTC, Superior proposed to divest as much as 215,000 metric tons of capacity,[6] which Superior contended would ''effectively reduc[e] Superior's pro forma market share of U.S. sodium chlorate sales to approximately 35%.''[7] Nonetheless, on June 27, 2016, the FTC filed an administrative complaint challenging the deal, citing concerns about the concentration of the market for sodium chlorate. The complaint alleged that there are no viable substitutes or meaningful imports of the chemical to compete, and that the deal was likely to lead to reductions in output, raised prices, and coordination. [8] In addition, the FTC's complaint alleged that Superior and Canexus ''cannot demonstrate cognizable efficiencies that would be sufficient to rebut the strong presumption and evidence that the Acquisition likely would substantially lessen competition in the North American market for sodium chlorate.'' [9]

On the same day, the Canadian Competition Bureau issued a No Action Letter stating that it would *not* challenge the merger.[10] The Bureau considered factors such as the elimination of overhead costs, freight optimization, and the elimination of duplicate corporate services, and determined that the projected efficiencies would outweigh competitive costs of the merger.[11]

IV. Efficiencies Analysis – What went wrong?

One of the FTC's biggest concerns regarding the merger was the reduction of output. According to the FTC, a decline in the demand for paper products has also led to a decline in demand for sodium chlorate.[12] In response, sodium chlorate producers have reduced capacity and increased exports in an attempt to raise prices.[13] ''As evidence of this, the FTC in its complaint claimed that in 2013 Superior paid another sodium chlorate producer for the exclusive right to its production and customer contracts with the stated purpose of reducing output. By 2015 Superior was paying the company to not produce any sodium chlorate, and by the end of 2015 Superior helped the company to exit the market entirely.''[14]

In a presentation to its shareholders regarding the merger, Superior claimed efficiencies such as the implementation of its ERCO technology, diversification of core businesses, South American expansion, and distribution optimization.[15] In addition, Superior indicated that the merger would insure ''strong free cash flow, with solid market positions. . . stable and predictable cash flow'' and reduce overhead.[16]

Alleging a stable and predictable cash flow was likely unconvincing to the FTC, as the agency was already concerned about the combined entity reducing output to raise prices. Unlike the Canadian Competition Bureau, the FTC likely took issue with vagueness and lack of quantification of efficiencies, even though there likely were some substantial cognizable efficiencies. Canexus claims its Brandon plant is ''the world's largest and North America's lowest-cost facility''[17] for the production of sodium chlorate, and that ''[d]ueto economies of scale and unmatched low-cost hydro-electricity rates . . . Brandon can deliver to more than 50% of North American pulp producers cheaper than anyone else.''[18] Moving production from less efficient plants to the Brandon plant may be a quantifiable, nontrivial efficiency, but it did not convince the FTC that the ben-

[3] Canexus website, http://canexus.ca/operations/north-american-sodium-chlorate/our-operations

[4] Press release, ''FTC Challenges Proposed Merger of Canadian Chemical Companies Superior Plus Corp. and Canexus Corp.,'' June 27, 2016, available at: https://www.ftc.gov/news-events/press-releases/2016/06/ftc-challenges-proposed-merger-canadian-chemical-companies

[5] ''Superior Plus Acquisition of Canexus,'' available at:http://www.superiorplus.com/News.php?id=1994952

[6] Sean Sullivan and Ben Gris, Bureau of Competition, ''What does it take to settle a merger case?'', July 22, 2016, available at https://www.ftc.gov/news-events/blogs/competition-matters/2016/07/what-does-it-take-settle-merger-case

[7] Superior Plus Press Release, June 20, 2016, available at: http://www.superiorplus.com/News.php?id=2071017

[8] Press release, ''FTC Challenges Proposed Merger of Canadian Chemical Companies Superior Plus Corp. and Canexus Corp.,'' June 27, 2016, available at: https://www.ftc.gov/news-events/press-releases/2016/06/ftc-challenges-proposed-merger-canadian-chemical-companies

[9] FTC Administrative Complaint, *In the Matter of Superior Plus Corporation and Canexus Corporation* at 59; available at https://www.ftc.gov/system/files/documents/cases/160627superiorcanexuscmpt.pdf.

[10] Competition Bureau statement regarding Superior's proposed acquisition of Canexus, June 28, 2016; available at:http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04111.html

[11] Id.

[12] FTC Complaint at 15.

[13] FTC Complaint at 36.

[14] FTC Complaint at 23.

[15] ''Superior Plus Acquisition of Canexus,'' available at:http://www.superiorplus.com/documents/Project%20Phoenix%20-%20Investor%20Presentation_vFinal.pdf

[16] Id.

[17] http://canexus.ca/operations/north-american-sodium-chlorate/our-operations

[18] Canexus Website, ''Our Operations,'' available athttp://canexus.ca/operations/north-american

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efits would be passed on to consumers. Reducing overhead is the type of reduction in fixed costs that would be unlikely to lead to lower prices in the short term, and thus is not the type of efficiency the FTC would give much credit.

In a blog post entitled ''What Does it Take to Settle a Merger Case?'' the FTC noted that ''Superior elected to abandon the transaction, rather than agree to additional plant divestitures that might have more completely addressed the risks of competitive harm posed by the merger.''[19] With regards to Superior and Canexus, the FTC was concerned about the competitive effects of a reduction of output in a highly concentrated market leading to increases in price; the complaint states that large reductions in capacity were already the trend in the market to stabilize price after a decrease in demand.[20] In order to bring about a settlement that would allow the merger to go forward, then, the merging parties would have needed to give up something of greater value than capacity they were in the process of shedding anyway, such as a complete line of business or a factory.

V. Conclusion— What does this mean for future chemical mergers?

So what does this mean for other larger chemical mergers? While the fate of Superior/Canexus should remind companies of the need to carefully quantify efficiencies and explain how benefits for the companies would be passed on consumers, the failed deal does not spell doom for other chemical mergers.

In the Superior/Canexus merger, the FTC filed its complaint with a pile of evidence that Superior had already engaged in precisely the type of conduct the FTC sought to prevent; namely, the restriction of output to raise prices. While Superior stated that restriction of output was the only way to stay afloat in a digital age that sharply decreased the demand for paper bleaching chemicals, few things spur antitrust regulators into action faster than a verbalized commitment by a company to raise prices through restriction of output. Superior and Canexus's merger challenge therefore cannot be analogized to other pending mergers in the chemical sector; the set of circumstances that caused the deal to crumble was very specific to these particular actors and the market for sodium chlorate.

Comparing how unimpressed the FTC was with Superior/Canexus's alleged efficiencies with the apparent weight given to those same efficiencies by the Canadian Bureau of Competition may be similarly uninformative about how relatively harsh U.S. regulators are regarding efficiencies. Canada's laws require that enormous weight be given to efficiencies, making it difficult for the Canadian Competition Bureau to challenge many mergers. But the FTC and Canadian Bureau of Competition worked very closely on the Superior/Canexus merger, and it may not be a coincidence that the FTC's complaint was filed the same day the Bureau's No Action letter went out. The Bureau could have easily relied on the FTC's challenge to stop the merger for them.[21]

With a wave of consolidation sweeping the chemical industry, it is understandable that the collapse of the Superior/Canexus merger might worry other companies with large deals currently pending. However, taking into account the special circumstances surrounding the Superior deal, its failure is not necessarily an omen of bad regulatory times ahead for other chemical mergers. Rather, it is a reminder that U.S. antitrust enforcers take efficiencies analysis seriously, and are looking for companies to present quantified, merger-specific efficiencies.

[19] https://www.ftc.gov/news-events/blogs/competition-matters/2016/07/what-does-it-take-settle-merger-case

[20] FTC Complaint at 38.

[21] Chemical Firms Abandon Merger Deal After FTC Objections, 110 ATRR 797, 7/1/16