

Chemical Industry Update - December 2018

by Troy M. Keller, Michael A. Lindsay, and Tiffany Shimada

"But the sense that something deeper is wrong also troubles the industry."

This quote from a recent [Economist article](#) reflects the disquiet of many when contemplating the magnitude of the legal challenges facing the chemical industry. The article suggests these risks have risen in recent years, potentially in game-changing ways. There is some truth to this view. Consider that in the last twelve months the industry has seen a proliferation of chemical regulation laws, the rise of plastics waste as a global issue, landmark product liability litigation over glyphosate, expanding PFAS liability (see below update), criminal prosecutions of Arkema officers over a hurricane-triggered explosion, and the adoption of surprisingly restrictive chemical policies by major retailers. And with the rise of ESG metrics and reporting, pressures in many of these areas are now coming from shareholders. It's a minefield.

From another perspective, the convergence of these trends—a coming to a head as it were—provides opportunity on the other side. It has long been a cynical refrain that heavy regulation, while costly, creates a competitive advantage for those companies with sufficient scale and sophistication to deal with it. We've seen this play out in China in recent years as many of the smaller chemical manufacturers have shut down in the face of enforcement of laws they were never really equipped to comply with. Savvy competitors—with which the chemical industry is filled—find ways to both influence policy where possible and adapt to an evolving landscape where not. That is why new challenges on the legal front are good reminders of the importance of staying informed, so as to make tough decisions with eyes wide open.

In the spirit of keeping you informed, below we've reported on some of the more relevant legal updates affecting the chemical industry in recent weeks. Feel free to reach out to us with any questions.

Concern over Flood of China Filings Leads to Proposed Trademark Rule

The U.S. Patent and Trademark Office ("USPTO") has proposed a [new rule](#) requiring

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foreign trademark applicants and registrants to use a U.S. licensed attorney to file documents with the USPTO. While the current rules allow *pro se* applicants both foreign and domestic to prosecute their own trademark applications, the new rule would change that.

The announcement follows USPTO Director Andrei Iancu's [April 2018 statement](#) before the Senate Judiciary Committee, in which he noted that applications from China represent nearly 10% of total new applications and that trademark filings from China increased by nearly 1,000% from 2013 to 2017. It has been [reported](#) that the rise in applications has been fueled by subsidies from regional governments in China that encourage Chinese companies to make foreign filings. Many of these applications are [said](#) to have technical or even fraudulent problems.

The USPTO hopes to improve the quality of applications from overseas by mandating the use of U.S. licensed attorneys. The rule is in the public comment period until February. If the current schedule holds, the new rule would become effective in July 2019.

PFAS Litigation and Enforcement Update

Recent weeks have seen a number of developments in the ongoing regulatory enforcement and litigation regarding the manufacture, and use, of products containing per- and polyfluoroalkyl substances (PFAS). First, on November 21, 2018, North Carolina announced that it reached a settlement with the Chemours Co. regarding air emissions and water discharges from its Fayetteville, North Carolina plant that produces GenX, a PFAS containing trade name compound. The draft consent decree, available [here](#), requires Chemours to pay \$12 million in civil penalties and another \$1 million to reimburse cost, reduce PFAS air emissions by 99% through the installation of new pollution control technology, address wastewater discharges from the facility, and fund human health and aquatic life studies on the effects of PFAS. In an unusual turn, the proposed consent decree gives Cape Fear River Watch—a non-governmental environmental organization—a role in monitoring and ensuring compliance with the terms of the consent decree. Second, on November 29, 2018, the 3M Company moved the Multi-District Litigation (MDL) panel to consolidate all pending litigation over PFAS contamination in groundwater, instead of just those cases relating to groundwater contamination caused by the use of aqueous film-forming foam fire suppressant. 3M asserts that regardless of the type of material alleged to have caused the contamination, these cases are ripe for consolidation because the real issue is the underlying chemical—PFAS. 3M's move is controversial, while some of the other defendants did not take a position on 3M's push for broad consolidation, other, like DuPont, have opposed the move for broad consolidation. These defendants argued that the cases are significantly different and consolidation would complicate matters rather than provide efficiencies.

Brexit's Impact on Chemicals: A Recap

For a long time, there has been significant discussion over how Brexit will impact the chemical industry. In recent weeks, the see-sawing over whether the draft agreement

reached by Theresa May with the EU will be approved has reinvigorated this discussion. Concerns tend to focus on two key areas. First, there is the fact that with Europe's integrated supply chain, raw materials criss-cross the channel multiple times before they are completed into finished goods. ICIS reports that if a hard Brexit takes place, petrochemical imports and exports with the EU and many of the EU's trading partners would face 6.5% tariffs. Second, there is the question of how chemical regulation will be addressed. For all REACH's issues, it is now a mature system with significant sunk costs, and to effectively require duplication in the U.K. could have a material consequence for the industry. One estimate of the total cost for companies submitting new data packages for a proposed UK chemical regulation under a hard Brexit could be as much as £1 billion. The proposed Brexit agreement includes a commitment for Britain and the EU to explore the possibility of cooperation between UK authorities and Echa, which would keep alive the potential for an integrated chemical management system.

EU Foreign Investment Screening

The European Commission recently announced it had reached internal agreement on a framework for screening foreign investment into member states. While generally leaving to its member states the question of whether to have a screening regime at all (14 of 28 member states currently do), the framework would require, if they do, that they meet common standards in terms of things like judicial review and transparency. The framework also seeks to promote cooperation among members states and to allow the EC to issue non-binding opinions on proposed investments that concern multiple member states or that could impact the whole of the EU. The framework is expected to become law at the end of the year, and has drawn criticism from China. While the overall structure is less protective than the centralized approach used by U.S. (via CFIUS), it nonetheless represents a significant (and controversial) step for Europe.

GDPR Update

This Dorsey & Whitney memo and its description of an enforcement proceeding involving a Canadian company flags an important question: How will GDPR's global protections be enforced against entities outside the EU? In this case, Canadian authorities cooperated with the EU authority, leading to a settlement. But without their involvement, it is unclear the EU's enforcement efforts would have gone anywhere, given the Canadian company's lack of a physical presence in the EU. The reality is that the international community has not developed a system for cross-border enforcement of privacy rights, and so uncertainty is likely to continue, particularly in jurisdictions like the United States that don't have a national data-privacy regulation like GDPR.

SEC Whistleblower Report Issued

Two weeks ago, the U.S. Securities and Exchange Commission (SEC) delivered its whistleblower report to Congress. The Commission reported receiving over 5,200 whistleblower tips in 2018 and granting \$168 mm in whistleblower awards, both records. Of interest to multi-national chemical companies based in the U.S., the SEC received whistleblower submission from individuals in 72 foreign countries. English speaking

countries generated the highest number of such tips (Canada, U.K. and Australia), but it is clear that the word is out internationally, and we should expect the trend to continue of a growing number of tips coming from overseas.

Intermediaries in U.S. Shareholder Voting System under Pressure

Each year, Proxy Advisors like Institutional Shareholder Services (ISS), Glass Lewis, and Egan Jones analyze the corporate governance of companies and make recommendations to institutional investors on how they should vote the shares they hold in U.S. public companies. Their recommendations are frequently controversial (at least for the companies being rated) and are now the target of an advocacy effort by the U.S. Chamber of Commerce and the National Association of Manufacturers. Recently, these groups stated in an open letter: "*proxy advisory firms operate without transparency, have rampant conflicts of interest, and are prone to making errors . . . Even worse, proxy advisory firms have advocated for politically motivated policies that actually reduce shareholder returns . . .*" By way of example, and of particular interest to the chemical industry, proxy advisors now rate a company's sustainability efforts and disclosures using a black box methodology that gives most companies no opportunity for dialogue or explanation.

In the last few weeks, a lot has happened in this space. The SEC held a roundtable on November 15, with one of the key topics being the role of proxy advisors. Probably no coincidence, a senate bill was introduced the day before the roundtable that would require the SEC to regulate proxy advisors under the Investment Advisors Act, including periodic reviews of conflicts of interest. Later that same week, the world's largest institutional investor, Blackrock, added its voice in calling for the SEC to regulate proxy advisors, noting that there are no standards or regulations that apply to their reports, their methodologies are not disclosed and potential conflicts of interest are hidden.

End of Quarterly Reporting Idea Slowly Gaining Traction

The SEC announced it would hold an open meeting on December 5 to consider issuing a request for comment regarding quarterly reporting. While a year ago, the idea of moving to semi-annual reporting would not have been taken seriously, momentum has been building since President Trump tweeted this summer that he was asking the SEC to study the idea.

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Antitrust Considerations Surrounding Non-Solicitation Clauses

In the Chemical Industry, employee no-solicitation and no-hire clauses (also referred to as no-poaching clauses) are commonly found in confidentiality agreements used in M&A projects and other strategic transactions. These clauses are less common in other commercial arrangements for good reason. In their 2016 Antitrust Guide for Human Resource Professionals, the Department of Justice and Federal Trade Commission made clear that, as a general matter, no-poaching clauses would be viewed skeptically;

indeed, naked no-poach agreements are a *per se* violation of the antitrust laws, and both in the *Antitrust Guide for HR Professionals* and in other public announcements, the DOJ has made clear that it will, in appropriate cases, prosecute these as criminal offenses. Solicitation and hiring restraints in the M&A context were generally seen as permissible *if* limited in scope and properly tailored under a “rule of reason” balancing test.

Over the course of 2018, there has been significant activity by regulators and private litigants confirming that no-poach clauses remain a cause for concern. In April of this year the DOJ disclosed they were actively investigating and prosecuting several situations involving no-poach clauses, including in the rail industry. Separately, several state Attorneys General began investigations into the use by franchisors of no-poaching clauses in franchise operating agreements. These clauses typically provide that franchisees will not hire employees of other franchisees or from the franchisor. A number of franchisors have settled the state AG cases by abandoning the no-poaching clauses. In many instances, the state AG cases have been quickly followed by class actions brought on behalf of franchisee employees.

The recent activity of the Attorneys General and the DOJ shows that there is a degree of risk to including these clauses in any context. There can be a valid reason for a limited no-hire/no-solicitation clause in M&A transactions, but these clauses should be handled carefully—particularly in HSR-reportable transactions, where antitrust regulators will see either the LOI or the definitive agreement during the course of their merger review. When negotiating employee non-solicitation clauses in the M&A context, counsel should take care to ensure that the scope of the clause (*i.e.*, which employees are covered) is not overly broad, customary exceptions are included, and the duration is no longer than reasonably necessary, typically not longer than a year after the discussions have terminated or the transaction has closed.

2018 Delaware Cases Reinforce Complexity of Earn-out Clauses

Delaware Vice Chancellor Laster once famously described earnout provisions as “*often convert[ing] today's disagreement over price into tomorrow's litigation over outcome.*” Two Delaware cases in 2018 reinforce that view. In *Edinburgh Holdings, Inc. v. Education Affiliates, Inc* the court denied a motion to dismiss because the general nature of the post-closing operating covenant would require a fact-intensive analysis. And in *Glidepath Ltd. v. Beumer Corp.* the court refused to fix what was alleged to be a mistake in the drafting, noting a high standard for reforming contracts. [This article](#) from Fried Frank walks through these cases in detail, but the take-away in our mind is that companies should use earnouts sparingly. These clauses are frequently litigated because of customized drafting (each deal is a new creature) and because of how fact-intensive the ultimate disputes tend to be. New caselaw each year tends to reinforce that reality,

Chem Industry Shareholder Activism Update

The Deal.com has [an interesting article](#) on the arc of A. Schulman's 13-year relationship with an activist, Jim Mitarotonda of Barington Capital. The story walks through

Mitarotonda's involvement in that company's strategy over the years, culminating in the sale to LyondellBasell, which included a novel use of Contingent Value Rights to retain the upside of a legacy litigation claim. In a [separate article](#), the publication comments how an Ashland activist investor is seeking to install a minority-slate of four directors with the goal of *delaying* any sale of what will be Ashland's remaining business (after it closes on the sale of its composites business to Ineos). If nothing else, the variety of tactics taken by activists in the chemical industry is a testament to the complexity and diversity of this industry in terms of business and strategic options.

Notes from All Over

Dorsey e-update on Trump-Xi Agreement. See [our team's perspective](#) on last week's cease-fire. *"During this interlude in the trade war, it is uncertain whether the U.S. Trade Representative (USTR) will offer much satisfaction to tens of thousands of U.S. companies who have filed exclusion requests with the USTR to be spared from the 25% tariffs already in effect from Lists 1 and 2. To date, no relief has been granted under that process."*

More Retail Regulation. Continuing a growing trend, Walgreens [adopted a chemical policy](#), joining the ranks of other major retailers, like Target, Amazon and Walmart.

India Petrochemicals Growth. Showing the ongoing growth of chemicals investment in India under PM Modi's "Make in India" initiative, the [Economic Times of India reports](#) \$26.1 billion in investment in four petrochemical regions and projected 300,000 associated jobs.

Ethane for Braskem Idesa. Mexico's president elect, Andres Manuel, campaigned partly on a promise to invest billions to increase Mexican petroleum production. [Reportedly](#), this would include a needed increase in ethane production for Mexico's domestic crackers. A major beneficiary could be Braskem Idesa's major ethylene complex, which has been running on 80-85% ethane supply.

Brazil's Ballooning Chemical Trade Deficit. Brazil's chemical-trade deficit is [expected to reach \\$29.1 billion](#) for 2018, a sizable increase over the (still large) \$23.4 billion deficit in 2017. For comparison, consider that Brazil had an overall trade surplus of \$67 billion in 2017.

Questions or requests? Contact [Troy Keller](#).