

Chemical Industry Update - June 2019

by Troy M. Keller, Kent J. Schmidt, Dave Townsend, Anthony P. Badaracco, and T. Augustine Lo

"This is the last worthless evening that you'll have to spend"

This Don Henley song from the '90s may not have been a classic (it's post-Eagles after all), but it conveyed a certain upbeat melancholy that was memorable. It acknowledged that the world can be rough, and in the same breath promised the worst was going to be behind you. As a business metaphor, you might say this line captures the feeling management has when a major challenge like burdensome litigation is finally resolved. Now we can get back to business!

Unfortunately, in the chemical industry that sentiment is becoming more and more elusive. For many, litigation and other forms of legal exposure have become persistent companions.

We have reported in prior issues on the proliferation of litigation associated with a variety of chemical products. Tort liability (relating to talc litigation) even led to a major [bankruptcy announcement](#) earlier this year. As minefields increase, it becomes important to identify potential sources of liability as early as possible and be prepared with a strategy before the worst arrives.

In this issue, we offer some insights into areas of potential exposure that might not have been on your radar. A good example is the recent update to California's Proposition 65, which creates a pathway for direct liability to move upstream to raw materials suppliers. Immigration law trends have also added to compliance risks, as has the evolution of antitrust enforcement activity around the world. We touch on these and others. And, because M&A transactions can expose unsuspecting buyers to new markets with different risk profiles, we offer some thoughts and strategies for due diligence in transactions in which new product lines are being added. Take a look, and let us know if you have questions.

Prop 65 Liability Update

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Over 30 years have passed since this California voter-initiative was passed, and the law remains as potent as ever today. In 1987, the Governor's List of chemicals requiring a Prop 65 warning was 30—today, it is over 900. Prop 65 has created a thriving cottage industry of litigation boutiques, enforcing the law through lucrative private actions, spurred by the threat of draconian penalties (\$2,500 per exposure) and public interest attorney fees.

Liability for Upstream Suppliers. Because most Prop 65 litigation is brought against the retailers or direct manufacturers, the law's impact on chemical companies has historically been more indirect, such as from product deselection by retailers and manufacturers who avoid listed products. Amendments enacted in 2018 have the purpose and effect of shifting the responsibility upstream, recognizing retailers' rights to limit their own liability by seeking reps and warranties and contractual indemnity to upstream manufacturers and raw material suppliers. A great deal of attention is being given to contractual provisions governing the relationships between raw material suppliers, manufacturers of component parts and other parties in the stream of commerce. We have been advising several clients positioned at various points in the distribution chain to utilize appropriate contract terms and best practices in addressing Prop 65 liabilities.

Propagation of Similar Statutes and Industry Response. Legislation similar to Prop 65 has been introduced in other jurisdictions such as Illinois, Maine, Oregon and Washington, as lawmakers seek to regulate various types of exposures, particularly in children's products. Supported by the American Chemistry Council, the Accurate Labels Act (S. 3019 / H.R. 6022) is a bill introduced in Congress in 2018 that would place limits and add requirements to state labeling regimes such as Prop 65. While not expressly preempting state labeling requirements, the law would add standards and limit the reach of these state standards, requiring science-based criteria and exempting liabilities for products with trace amounts of certain substances.

For more information, contact [Kent Schmidt](#).

Immigration Audits Create Risk for Employers

Many employers have been subjected to audit notices from Immigration and Customs Enforcement (ICE). According to ICE's own website, it has increased its I-9 audits by more than 300 percent since President Trump signed the "Buy American and Hire American" Executive Order two years ago, on April 18, 2017. We recommend that employers secure legal counsel if they receive such a notice. ICE has broad subpoena powers and the ability to impose civil and criminal penalties on employers who fail to comply with their obligations to complete and maintain forms I-9 as required by the Immigration Reform and Control Act (IRCA).

ICE has authority over companies that engage independent contractors too. If ICE believes the company is classifying workers as independent contractors (or using a third-party staffing company) to avoid the requirement to complete a form I-9, and is knowingly engaging foreign nationals without work authorization, it can impose penalties on that

company.

In addition to the increased ICE audits, in March of 2019, the Social Security Administration (SSA) resumed its practice of sending “no match” letters to employers when the names on W-2 (or other IRS forms) do not match the social security numbers. As it notes on its website, it is encouraging employers to correct such errors and to file the Form W-2c with any corrections necessary.

It is important to keep in mind that a no-match letter does not automatically mean that an employee is not authorized to work in the U.S. or that the employer will also receive a notice of audit from ICE. The SSA sets different verification requirements and it is important to realize that deviating from the obligations to correct W-2 mistakes with the SSA may create discrimination liability under other laws protecting employees (including workers not authorized to work in the U.S.).

Immigrant and Employee Rights Section (IER) investigates discriminatory treatment during the Form I-9 and E-Verify processes. Employers may not discriminate, based on citizenship status or national origin, nor because of an accent. IER would also have jurisdiction to investigate discriminatory treatment if an employer is attempting to resolve an SSA no match notice.

For more information, contact [Rebecca J. Bernhard](#).

Antitrust Trends for Manufacturers

While antitrust enforcement and policy reform targeting the tech industry have been much in the headlines of late, competition laws around the world create compliance risk for companies of all shapes and sizes. The chemical and materials industries are no exception. We have noticed several trends around the world that are particularly relevant for manufacturing companies.

- **Cartel Enforcement.** Several countries have indicated they are strengthening their cartel enforcement regimes. Malaysia’s competition commission resolved its first bid-rigging case, and Australia’s commission has opened new cartel enforcement actions and indicated that it intends to continue becoming more active. Thailand, a country that adopted competition law regime in 1999 but to date has not lodged a cartel action, recently restructured its regulatory body in anticipation of becoming active in terms of enforcement. (See more in [this article](#) from the East Asia Forum.) India and China continue to grow their enforcement agencies and to be more muscular in their approach.
- **Vertical Mergers.** In terms of merger control, the U.S. Department of Justice recently litigated a vertical merger case for the first time in 40 years (in this case, in the media industry). Though the DOJ lost, leaders from both federal enforcement agencies have indicated that they are investigating other mergers with a focus on vertical theories of harm. The European Union has long relied on vertical theories in its review processes, as has China. This has always been of particular relevance to the chemical industry, where business lines are frequently back-integrated. With many companies moving downstream into materials and formulations, vertical merger enforcement becomes even more relevant.

- **ACPERA Renewal.** The Antitrust Criminal Penalty Enhancement and Reform Act (ACPERA) in the U.S. allows a company that self-reports illegal cartel activity to the Department of Justice to be liable for only single, rather than trebled, damages in any follow-on civil suits. That law is up for renewal in June 2019. Following recent hearings, everyone seems to agree it will (and should) be renewed because it is a powerful incentive for companies to assist the government, which increases the likelihood that cartels are detected and prosecuted efficiently.

For more information, contact [Anthony Badaracco](#).

Mexico Tariffs and Risks for USMCA

On Thursday, May 30, 2019, the White House threatened to impose a series of escalating tariffs on U.S. imports from Mexico, starting at five percent on June 10, and scheduled to increase to 25 percent by October 1, 2019. Citing the influx of migrants crossing the U.S.-Mexican border, the White House indicated that the tariffs would take effect unless the Mexican government significantly abates the problem in the “sole discretion and judgment” of the Trump administration.

As support for this threatened measure, the White House cited presidential authority under the International Emergency Economic Powers Act (IEEPA). In the past, presidents have invoked IEEPA to impose economic sanctions on hostile foreign countries and persons who engage in actions that are inimical to U.S. interests (e.g., Iran, Syria, North Korea, Russia, and Venezuela).

This appears to be the first time that a U.S. administration has invoked IEEPA against a major trade partner. It also appears to be the first time that a president has invoked IEEPA to levy an import tariff, instead of prohibiting commerce with a hostile foreign party.

At this time, it is uncertain how the threatened tariffs will impact the approval of the recently signed U.S.-Mexico-Canada Agreement (USMCA), which is supposed to replace the North American Free Trade Agreement (NAFTA). Canada and Mexico recently reached agreement with the United States to lift the U.S. Section 232 tariffs on steel and aluminum articles to facilitate USMCA approval in the three countries. If implemented, these new tariffs could create a new obstacle for that effort.

We also see a likelihood of legal challenges to these new tariffs. As NAFTA remains in force, Mexico may invoke NAFTA’s dispute resolution procedures to challenge the new tariffs. Also, private parties can mount a challenge in U.S. courts, seeking to prevent the application of the tariffs on goods imported into the United States.

For more information, contact [David Townsend](#) or [Augustine Lo](#).

In Case You Missed It

California Bill Would Exclude Employee Information from California’s Consumer Privacy Law. Our [eUpdate](#) summarizes the bill that passed the California Assembly and

is now moving to the state's Senate.

OFAC Provides Sanctions Guidance. Our [eUpdate](#) discusses new guidance from OFAC with respect to implementing effective sanctions compliance programs.

China Opens Tariff Exclusion Process. Our [eUpdate](#) discusses the most recent round of 301 tariffs, China's retaliatory steps and an exclusion process being run in China.

Notes from All Over

Cefic's New President Comments on Circular Economy. Daniele Ferrari, CEO of Versalis and President of Cefic, [comments on the chemical industry's role](#) in solving sustainability challenges and promoting a circular economy.

Washington Chemical Law. In May, Washington State passed the [Pollution Prevention for Our Future Act](#), perhaps the strongest state law regulating toxic chemicals in products. It prioritizes a number of chemical classes for determination and action.

More Criminal Charges Levied in Texas Against Chemical Companies. As yet another example of Harris County's aggressive approach toward chemical companies, [misdemeanor criminal charges](#) were brought against Intercontinental Terminals Company for pollution arising from a fire in March that sent smoke over the Houston area.

Basel Convention Amendment Reduces Options for Plastics Recycling. 187 governments [agreed to changes](#) to a global waste treaty that limits movement of mixed-plastic bales of waste across borders.

EU Parliament Weighing in on Chemicals Policy. For technical, chemreg actions, the Parliament has historically been viewed as providing a rubber stamp to the outcomes of the European Commission's extensive and technical processes. Recent actions show the Parliament being [more aggressive](#).

FMC Spinoff Hit with Securities Litigation. On May 23, Livent Corp., a producer of lithium compounds, was sued in a shareholder lawsuit alleging that in its IPO it failed to disclose it had lost a key supplier and other facts (Note: [this article](#) is behind a paywall).

WOTUS Decision. Last week, the Waters of the United States rule [was struck down](#) by the U.S. Court for the Southern District of Texas for violating aspects of the Administrative Procedures Act. WOTUS was adopted in 2015 under the Obama Administration has been controversial from the start with its significant expansion of federal jurisdiction over small and isolated bodies of water. It was challenged in a number of courts and then was suspended by the EPA in early 2018. Earlier this year, the Trump Administration issued proposed rulemaking to effectively replace the rule.

MERGERS & ACQUISITIONS

Due Diligence Trends & Strategies

Nearly every M&A transaction begins with a look at the possibilities: the strategic fit; the synergies; the drivers for the deal. Naturally enough, the next step will turn to an evaluation of risk. Traditionally, legal exposure from toxic tort and other forms of product liability has rated high on the list of issues to identify and protect against—up there with environmental liabilities and compliance exposures. Recently, however, eye-popping damage awards have raised the stakes, suggesting that acquirers may consider additional due diligence steps, particularly when acquiring new product lines in businesses with which they are less familiar.

In the past, during the due diligence phase one would expect to negotiate liability protections with respect to *existing* and *threatened* litigation. If a target company had asbestos exposure for example, that docket and the potential for additional cases would be assessed and indemnities might be negotiated or a reps & warranties insurance policy might be entered into to cover that risk. But trying to protect against legal liability that may emerge *in the future* has been viewed as a speculative exercise. It has been in the category of “risk factors” that a buyer simply needed to swallow or factor into the price it was willing to offer.

The Bayer – Monsanto merger may have changed things. Two weeks ago, Fortune reported that Bayer’s stock price has fallen over 44 percent since the merger closed and tied the fall to shareholder worries about exposure from glyphosate litigation. Glyphosate had been a controversial product for some time, but this had not translated into direct legal liability prior to the merger. Bayer clearly felt that the opportunities outweighed the risks.

Deals will always be evaluated in hindsight, and risk assessment is never perfect. There is a point where people are indeed just speculating. But buyers can and should avail themselves of every opportunity to understand regulatory, industry and social trends that may impact the value of their acquisition in the future. This could mean going beyond some of the standard techniques.

One aspect of this type of expanded due diligence involves hiring the right advisors. Private equity buyers have long understood the importance of hiring industry consultants when evaluating a business. Strategic buyers may have less of a need, given they bring their own internal experts, but when getting into a new line of business, they may need to think more like private equity.

Regulatory trends should also be reviewed. Products that have been vetted through a fulsome regulatory process (such as Europe’s REACH process) may be less likely to face challenges in other jurisdictions. On the flipside, if a target’s products are listed or proposed to be listed as priorities for action in states like California or Washington, this obviously should raise red flags.

Getting access to the right people during the due diligence process is key. A group that is sometimes overlooked is product managers. These are the line managers who are in

the weeds of the day-to-day discussions with customers and other industry players. They spend their time worrying what might change across the landscape in which they sell. Particularly, if an acquirer is looking to bring in new product lines it is not familiar with, discussions with the relevant product managers can be revealing.

Finally, some law firms (like ours) are becoming more industry focused because of the simple fact that it lets us bring regulatory and industry knowledge that is fit-for-purpose. In the ordinary course, legal advisors tend to be at the center of the due diligence process anyway since identified risks need to be factored into the liability provisions of the contract. Having a team of lawyers who understand your industry well allows them to ask the right questions and filter the information more effectively.

For more information, contact [Troy Keller](#).

SEC Rulemaking on Proxy Advisors and Shareholder Proposals

Since its Proxy Roundtable last fall, the SEC has continued to send signals that it is serious about looking to make changes in the way that proxy advisors are regulated and shareholder proposals are made. Given the number of shareholder proposals that target the chemical industry and several of its key downstream markets, such as food and agriculture, regulations that push for more fairness in these areas are likely to be welcomed. Last week, the SEC posted [formal notice](#) of its intention to propose rules in these and other areas this year.

For more information, contact [Troy Keller](#).

To learn more about Dorsey's chemical industry practice, contact [Troy Keller](#).