

Chemical Industry Update - November 2018

by Troy M. Keller and Cam C. Hoang

The Future of Chemical Regulation

A lot is happening right now in the world of chemical regulation. In the Americas, just in October: Argentina and Brazil announced an MOU to work together on chemicals management; Brazil then released its draft law for industrial chemicals regulation (though the outcome of the presidential election last week may put its passage in doubt); both Mexico and Chile took steps toward rolling out classification and labelling regulations for chemical substances; and the U.S. has a new substances backlog under TSCA of 550 cases. On the other side of the Atlantic, in an [open letter](#) to Heads of State, industry associations highlighted the risks of a hard Brexit in which the UK is outside the REACH regime, which could lead to duplication of chemical registrations and a complicated untangling of regulatory coverage. Also in Europe, its circular economy initiatives (which we reported on [last month](#)) came under pressure from a number of industry groups arguing that instead of mandating participation in an expensive database of allegedly harmful substances in products, the EU should invest in R&D for recycling technologies, testing methods and circular production models (see more [here](#)). And in Asia, its major economies have been fine-tuning existing chemical regulations of late, with regulatory updates reported last month in Malaysia, China and Taiwan.

What does this all mean? Certainly, gone are the days when REACH was the only serious chemical regulation out there. As nations continue to adopt, update and enforce their chemicals laws, the future will involve a landscape that is more fragmented but also (hopefully) more predictable than in the past. Compliance costs will rise, not just for chemical sellers but on down the value chain. This will be offset by more transparency and a clearer path to approvals, leading to more predictable access to markets. However, engagement—not just by industry associations but by individual companies—is needed to push policy makers for as much alignment as possible among jurisdictions.

Burden of Proof Clarified in DuPont Patent Infringement Case

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Patents in the chemical arts are often granted based on tiny differences over prior art, such as the reacting of components at a slightly different temperature or pressure from what has commonly been done in the past. This can make defense of these patents difficult when a challenger brings a case alleging a patent's claims are not sufficiently inventive (*i.e.*, that they are obvious). Making things even more complicated, it has been unclear in the past when or even if the patent holder needs to make its case for “non-obviousness” at the all-important *inter partes* review stage of a patent challenge. (Today, instead of challenging patents in Federal District courts, many would-be litigants contest the validity of patents via *inter partes* review proceedings held before the Patent Trial and Appeal Board, an administrative court at the United States Patent and Trademark Office.) In *E.I. DuPont De Nemours & Co. v. Synvina C.V.*, 2017-1977 (Fed. Cir. Sept. 2018), the Federal Circuit held that once a *prima facie* case of obviousness is established against patent claims, the burden shifts to the patentee to rebut the presumption of obviousness at the *inter partes* review proceeding. The patent holder can then present many different forms of rebuttal evidence, such as criticality of a claimed range to achieve unexpected results or a teaching away from the claimed range in the prior art references, to show that its patent represents real innovation. This clarification of the burden-shifting—including that the patent holder should present its evidence of non-obviousness at this early stage—is significant, particularly in chemicals cases, as it will in many instances tend to push the real fight to the beginning of the proceedings.

Is Your Supply Chain Impacted by List 3 Tariffs?

The 301 Tariffs on Chinese imports are affecting the chemical industry's supply chain, impacting some companies more than others. As mentioned in our [prior update](#), many companies are seeking exclusions on specific products that are critical to their value chains, and Dorsey has been actively involved. However, so far, the exclusion process has only been available for products on the first two lists. There has been no indication that USTR will offer a similar process for the third list, even though the third list covers four times the amount of imports as the first two combined (and a significant number of chemical products). Members of both the [House](#) and [Senate](#) have now sent letters to the USTR calling for an exclusion process for these goods as well. We hope their efforts are effective.

US-China Business Council Encourages China to Adopt Tariff Exclusion Process

On October 23, the US-China Business Council sent a [letter](#) to China's Minister of Finance encouraging China to (i) adopt a Public Comment Period for proposed tariffs on U.S. imports into China and (ii) establish an exclusion process (similar to the process in the U.S. referenced above) that allows companies to apply for exclusions of specific products from the tariff list. It will be interesting to see China's response (none yet), but if an exclusion process is established, this will give companies an opportunity to make the case for why their imports should be excluded. We will send out a special update on this topic if there are developments.

Investors Push SEC for Rulemaking on Sustainability Disclosures

A growing body of investors are seeking improved disclosures and board oversight with respect to ESG (environmental, social and governance) topics. A cottage industry has formed of ESG analysts purporting to rate companies on their performance in these areas. In this environment, it can be challenging for companies to determine (1) which ESG issues to prioritize and (2) which standards are appropriate and helpful to their investors and other stakeholders. Purporting to offer a solution, a coalition of law professors, NGOs and institutional investors representing more than \$5 trillion in assets have signed a petition for rulemaking, calling on the Securities and Exchange Commission to require public companies to uniformly disclose ESG information. The petitioners emphasize the need for the SEC to bring coherence to this area, citing existing, multiple initiatives on human capital management, climate, tax, human rights, gender pay ratios and political spending.

Indeed, a standardized protocol for ESG disclosure might bring clarity and efficiency to the ESG disclosure process, but many companies hesitate to introduce ESG information in SEC reports because they question the materiality of the information for financial reporting purposes and because they have already crafted an ESG message in their separate sustainability reports. They also worry about liability for getting it wrong (see the below update on the ExxonMobil case in New York). If disclosures do become required, allowing for disclaimers and safe harbors, similar to those currently provided to forward-looking information, could make companies more comfortable with standardized disclosure.

New York Attorney General's Office Uses Securities Laws to Push Climate Change Agenda

Already, one company is facing potential liability as a result of its disclosures attempting to quantify the impact of climate change on its business. Recently, in *People v. Exxon Mobil*, N.Y.Sup.Ct., the State of New York filed a fraud lawsuit in state court against Exxon, accusing the company of misleading investors about how future regulations could impact its business. As discussed in this [Law360 article](#) (in which we are quoted) whether the AG's office was motivated primarily by a desire to protect investors or more to promote social policy is far from clear.

Mergers & Acquisitions

CFIUS Pilot Program Includes Petrochemicals and Base Inorganics

Last month, the Treasury Department rolled out a "Pilot Program" using their expanded authority under FIRRMA to mandate reviews of all foreign investments that meet certain criteria and are in specified industries. See details in our update [here](#). Petrochemicals and base inorganic chemicals are included on the list of these industries, as are several downstream industries important to the chemical industry, including aircraft manufacturing, battery technology, nanotech and biotech. Foreign investments into these segments will face an additional hurdle for the foreseeable future.

Akorn Decision: What it Means for Chemicals M&A

One of the seminal cases on the enforceability of material adverse change (MAC) clauses is *Hexion Specialty Chems. Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008), in which the court found that a business downturn in the short term does not justify finding a MAC. That dispute between global chemical players was set against the backdrop of business cycles that are part and parcel with operating in this industry. Some of these themes have been revisited in the *Akorn, Inc. v. Fresenius Kabi AG* decision, in which a Delaware court found for the first time that a material adverse effect had occurred and justified termination of a merger agreement--though in the Akorn case there were factors in addition to business downturns, such as compliance and internal control deficiencies. See more in our client update [here](#).

Due to certain characteristics of the chemical industry, chemicals M&A is primed for more of these types of disputes in the future. First, deals frequently take a long time to close. Many segments of the industry are consolidated (or nearly so), such that regulatory reviews in those spaces are more complicated. And because chemical companies tend to operate in both established and emerging markets (where more merger control regimes have emerged in recent years), deals tend to be reviewed in more jurisdictions than they used to. The more complex and longer review periods, combined with inherent cyclicity in many industry segments, increases the odds that a business case on which a deal was based may look very different six or nine months later, with the deal still pending.

The Akorn decision is useful in this environment because it sets goalposts for how bad it might need to get for a court to find a MAC has occurred. For buyers who see the Akorn standard as too high a bar to be a useful protection, adding objective criteria into a MAC definition (such as setting EBITDA floors) remains an option--though this approach has never really caught on in the industry. For private deals, earn-outs have become popular as a middle-ground tactic to protecting a buyer's downside, but these constructs provide limited protection. Whatever approach is taken, it is worth remembering that Delaware courts have consistently said that customized contract terms will be respected. Nuanced drafting of clauses by lawyers who understand the risks that are most likely to impact chemical businesses in the near term and the trends that are likely to affect the industry in the long-term could tilt the scales in a close call situation.

Impact Investing as a Solution to Plastics Waste

The industry effort to address plastics waste is taking several forms. One of the more innovative approaches appears to be that of seeding technology and infrastructure investments through social impact funds. Last week, it was reported that Dow would be participating in the \$90 mm round of financing in a new venture called [Circulate Capital](#), whose business model involves investing in waste management and recycling infrastructure across Asia. In October, Amazon [announced](#) it was investing \$10 mm into the Closed Loop Fund, an organization formed by major retailers two years ago to improve recycling in the United States. These types of efforts to seed investment in the recycling industry could have both a long and short-term impact. Long-term, there is the

prospect of real solutions being developed. Short-term, even the identification of promising technologies builds optimism that solutions will be reached. However, there is also the risk that impact funds may invest in solutions that take the market in a different direction, such as toward plastics replacements. Focus and awareness by the industry is called for.

Questions or requests? Contact Troy Keller.