

Chemical Industry Update - October 2018

by Troy M. Keller, Catherine X. Pan-Giordano, and Kent J. Schmidt

Governance: Environmental Activism Encroaches Further into the Board Room

It's been another busy month on the ESG (Environmental, Social & Governance) front. You may recall from last month's [update](#) that Senator Warren introduced a bill to require all large public companies to have a social purpose along with a financial one. In the spirit of bills that will go nowhere but are intended to make a statement, this month she introduced legislation that would require the SEC to issue rules mandating companies disclose in their public filings an array of impacts their operations could have on the environment and visa versa. Like last month's bill, this one is not coming in a vacuum. Shareholder proposals on climate change and sustainability measures were by far the largest category of proposals received this year (representing 139 out of 788 proposals submitted by shareholders). Few of these have passed, but the pressure is mounting. Even institutional shareholders like State Street, Blackrock, Vanguard, Fidelity and UBS have publicly announced voting policies in support of climate change resolutions. This feels something like the "shareholder rights" trends of the late 2000s, in which proposals for majority voting, proxy access, eradication of staggered boards and others, were launched at corporate America successively until, over time, they led to change at virtually every major public company.

California: New Prop 65 "Safe Harbor" Regulations Take Effect; Flame Retardants Ban

New California regulations governing the content and methods of communicating consumer warnings under Prop 65 took full effect August 30. Consistent with the unusual framework of Prop 65, the new regulations build on an unorthodox legislative framework by adopting a series of "safe harbors" which now extend to the manner in which Prop 65 warnings are conveyed and language that is used in the warning. (See more detail [here](#)). The latest regulatory changes have been in process since 2012, and the controversy that swirled around the regulations during the proposals phase has not subsided. Industry complains, with some merit, that the new regulations create more

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questions than they answer. The new “safe harbors” will no doubt figure prominently in litigation claims, making it virtually impossible for a defendant to argue that its warning was conveyed in a “clear and reasonable” manner if it deviates from the safe harbor. Industry experts expect to see an uptick in Prop 65 claims in the near future. Separately, on October 1, California signed into law a ban on the use of most flame retardants in residential products, like furniture, children’s products and mattress foam. Putting aside the costs of reformulating across a vast array of products, creating differing product offerings for different markets is an enormous inefficiency. California is not getting easier for the chem industry.

Europe: Circular Economy Initiatives Bring Additional Costs and Risks

Waste management, including recycling, is arguably the most significant issue facing the chemical industry today, and regulators around the world are sharpening their pencils. Motivated by a desire to provide transparency regarding hazardous substances as they flow through the economy, earlier this year the European Commission established a database in which suppliers will be required to register with the European Chemicals Agency (ECHA) the presence of Substances of Very High Concern (SVHCs) in articles they sell. SVHCs are designated as such only after a vetting and review process. Last month, the European Parliament took this a step further by adopting a resolution calling for the Commission to extend requirements to a much broader universe of chemicals. For now it is just a proposal, but if implemented as proposed, this would bring a real “cart before the horse” challenge. Marco Mensink (Director General of Cefic) explained it to us this way: *“The information obligation is already there for SVHCs -- no news there. Moreover, blockchain and customer demands will already drive us into this direction. By 2030 one will have to share information with the supply chain one way or another, up and including the waste and recycling stages. It is the extension of the definition from SVHC to substances of concern that makes us very unhappy -- as it will cover substances that have not been assessed or classified yet -- just listed for further action.”*

China: Soil Pollution Law

On August 31, China passed legislation on soil pollution prevention and control, which will go into effect on January 1, 2019 after national standards are set by environmental authorities. Monitoring stations, 10-year censuses, creation of public lists of toxic substances in the ground, and formation of remediation funds will be part of the new regulatory regime. While much of the legislation is targeted toward construction projects and agricultural lands, the law will create obligations across the board. The law follows a “polluter pays” principle, and requirements for investigation are triggered by occurrence of pollution events or transfers of property. Chemical companies operating in China will be well served to review and update their EHS policies in advance of January 1, and companies considering sales or acquisitions of property should factor into their processes the likelihood of environmental reviews by authorities.

Trade: China 301 Tariffs – Companies Filing Exclusion Applications

As noted by the American Chemistry Council, with the third listing announced last month,

over 1,500 chemical products are now impacted by the various Section 301 tariffs. (See this [Dorsey update](#) for more details on the third listing.) Just as painful, China's retaliatory tariffs now impact over 1,000 U.S. chemical exports. Many companies are filing 301 exclusion applications with respect to their key imports. Not many will be granted, but some will. Let us know if we can help. To be seen is whether China will provide reciprocal relief within a value chain where the related tariff on the U.S. side is lifted.

Mergers & Acquisitions

The Whirlwind Nexeo Story Culminates in Sale to Univar

The distribution sector of the Chemical Industry has seen significant consolidation in recent years, evolving from countless local, regional players into a handful of global ones. Nothing illustrates this phenomenon better than Nexeo's story, which has involved a series of transforming corporate transactions over a relatively short period of time. Nexeo was originally created as a carve-out of Ashland's chemical distribution business in 2011. The new company then embarked on a series of joint ventures and acquisitions to become one of the five largest in its space. In 2017, Nexeo went public via merger into a special purpose acquisition company (SPAC) sponsored by Wilbur Ross. The SPAC structure is one that has gained credibility in recent years, and the Nexeo example demonstrates its utility in the Chemical Industry, particularly in the mid-market space. Now, the company's planned merger with Univar promises to bring the Nexeo business onto a mature platform.

Clariant and SABIC Take Their Relationship to the Next Level

On September 9, Saudi Basic Industries Corp (SABIC) received the last of the regulatory approvals it needed to complete its purchase of a 24.99% interest in Clariant. This interest was acquired from hedge fund sellers who had accumulated the stake as part of a strategy to block the Huntsman-Clariant merger in 2017. Approvals in hand, SABIC and Clariant have now announced a joint venture involving the combination of Clariant's masterbatch business and parts of SABIC's performance materials. The companies will also enter into governance arrangements by which Clariant's board of directors will include four SABIC appointments going forward, and a current SABIC executive will become Clariant's chief executive officer. These steps are not insignificant, and some have noted the uncertainty the new arrangements introduce into the governance of Clariant. These steps also test the limits of what can be done with a large but non-controlling interest. Fiduciary duties owed by Clariant's board members are intended to protect against arrangements that are not in the best interest of Clariant's shareholders broadly. Getting that right can be tricky, and decisions sometimes look bad in hindsight. As such, it may be that the two companies stop short of doing more absent SABIC acquiring a fully controlling interest (which it has said it has no present intention of doing).

Plastics Compounding

In August, LyondellBasell acquired A. Schulman Inc., a plastics compounding platform company. Last week, Westlake Chemical announced the acquisition of a French compounding business (Nakan). As noted above, SABIC and Clariant are merging their masterbatch and performance materials businesses. Consolidation, both horizontal and vertical, is in the air in the plastics compounding segment.

Questions or requests? Contact Troy Keller.