



# Decion 2008:

## *Implications for Your Supply Chain Business*

By Benjamin Gordon

*"In this world nothing can be said to be certain, except death and taxes."*

Benjamin Franklin's observation is as true today as it was in 1789. In 2008, we face a highly uncertain Presidential election. Senators Barack Obama (D-IL), Hillary Clinton (D-NY), and John McCain (R-AZ) represent dramatically different scenarios for the logistics sector. What are the implications of the 2008 elections for the supply chain sector, how can you prepare, and what opportunities should you pursue?

As the elections approach, here are a few topics that you should watch closely as you seek to position your business for success:

- Card check: the new unionization drive
- 100% inspection: cargo screening and the growing cost of compliance
- Free trade frozen: threats to NAFTA
- The taxman cometh: the likelihood of tax hikes

### **Card Check: The New Unionization Drive**

A little-known Congressional bill could have enormous implications for supply chain companies. The Employee Free Choice Act could enable unions to mount drives via a new tool: the public vote.

Historically, employees voted for or against a union via secret ballots. However, under the recently-proposed Employee Free Choice Act, employees would vote for unionization via public election, not private ballot. Hence, if a majority of employees were to vote for union representation via Card Check, the National Labor Relations Board (NLRB) would be required to recognize the union. In the Card Check process, all the union needs to do is gather a list of employees declaring their support, and if the list reaches a majority, the company can be forced to go union.

The implications are dramatic. Post-Card Check, employers could lose the right to request an election or respond by educating their workforce on the pros and cons of unionization. Many non-union companies fear that Card Check will put their companies at risk of union drives which could undermine the private vote, increase costs, and make their companies less competitive.

On Card Check, the presidential candidates split on party lines. Democratic Senators Hillary Clinton and Barack Obama have both expressed their commitment to passing the Employee Free Choice Act legislation. Conversely, Republican Senator John McCain co-sponsored the opposing Secret Ballot Protection Act.

With a Democratic Congress, a Democratic Senate, and polling showing a lead for the Democratic Presidential candidates, it appears very possible that we will see a Card Check bill pass.

### **100% Inspection: Cargo Screening and the Growing Cost of Compliance**

The Department of Homeland Security has been actively pursuing initiatives to create more transparency throughout the supply chain, but sometimes with little regard to who will pay for it. The burden is likely to fall on freight forwarding, customs brokerage, and international logistics providers.

A recent development is the 100% inspection initiative. Ever since 9/11, Congress has debated legislation to screen all cargo. Some have objected that the commercial implications could be devastating. "If you have 100 percent physical inspection of cargo, you are basically going to shut that part of the economy down," said Jim May, president of the Air Transport Association.

Nevertheless, the Democratic-controlled Congress passed this proposal, now Public Law 110-53, as part of the 9/11 Commission Report Implementation Act. As a result, the Transportation Security Administration (TSA) must achieve 100% of air cargo screening by August 2010. TSA may impose an unfunded mandate, requiring supply chain companies to take on the costs and responsibilities of screening and certifying all cargo prior to arrival at an airport.

The implications for the supply chain could be devastating. Potential consequences include increased costs of compliance and certification, delayed shipments, increased prices, and reduction in air cargo. Small and medium sized supply chain businesses that lack deep pockets may not survive the onerous requirements.

All three presidential candidates voted in favor of this inspection bill in the Senate. The trend toward heightened global security

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legislation and increased costs for supply chain businesses is bipartisan and will likely continue. It is likely that small businesses that cannot invest aggressively in new technology, services, and compliance costs will find it difficult to compete.

### Free Trade Frozen: Threats to NAFTA

The North American Free Trade Agreement (NAFTA) also frames the differences between the candidates. Since 1994, NAFTA has removed trade barriers in the form of tariffs between the United States, Mexico and Canada.

Both of the Democratic presidential candidates have attacked NAFTA. For instance, Senator Obama declared: "Trade deals like NAFTA ship jobs overseas and force parents to compete with their teenagers to work for minimum wage at Wal-Mart." Senator Clinton has echoed this criticism, joining Senator Obama in calling for a renegotiation of NAFTA.

Conversely, Senator McCain has spoken out in favor of NAFTA and other free trade accords, saying, "I believe that those agreements should be kept."

If international tariffs are reinstated by the next party in power, what implications will that have on cross-border supply chain companies and their partners?

### The Taxman Cometh: The Likelihood of Tax Hikes

The Bush tax cuts are another example of an endangered policy that engenders opposite reactions.

The Bush tax cuts were extensive. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) lowered individual income taxes for all taxpayers. In addition, the Act lowered the top income tax rate from 39.6% to 35%. Thereafter, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) slashed

the maximum capital gains and dividends rates from 20% and 35%, respectively, down to 15%.

These tax cuts were favorable for M&A. Logistics mergers boomed during the reduced capital gains era, in part fueled by the reduced capital gains that sellers stood to receive. Deals such as PWC Logistics-GeoLogistics, Jacobson-Wilpak and ZLN-Interlog all took place during this favorable environment. In aggregate, 2007 represented the most active logistics M&A year ever recorded.

However, current levels are unlikely to continue. Of the three Presidential candidates, two propose to raise taxes. Both Senator Clinton and Senator Obama support higher rates. Senator Clinton has proposed increasing maximum capital gains to 20%, income taxes to 39.6%, and dividend rates to 39.6%. Senator Obama, on the other hand, also supports a 39.6% maximum income tax rate, but would increase capital gains and dividends to 24%.

Senator McCain proposes maintaining the current tax levels. However, it is worth noting that Senator McCain is unable to ensure that taxes will not increase. Tax legislation must be passed by the Congress. If the 2009 Congress is solidly Democratic, as currently appears likely to be the case, then Senator McCain may be forced to reach an accommodation. In addition, the Bush tax cuts are currently scheduled to "sunset," or expire, by 2011, at which point they revert to the pre-Bush higher levels. So it seems reasonable to assume that taxes under a McCain presidency and a Democratic Congress would be unknown.

What does this mean for you? If you own a mid-sized logistics company, how would your after-tax results compare? Let's assume that (a) you generate \$5 million of earnings before interest, taxes, depreciation, and amortization (EBITDA), (b) a buyer pays you a 6x multiple for \$30 million, and (c) you have a cost basis of \$5 million. All things being equal, you would be taxed on a capital gain of \$25 million. The table below provides an illustration.

	Obama	Clinton	McCain	Current Tax Code (2008)
<b>Pre-Tax</b>	\$30 million	\$30 million	\$30 million	\$30 million
<b>Capital Gains Tax</b>	\$6 million (24%)	\$5 million (20%)	Unknown	\$3.75 million (15%)
<b>Post-Tax</b>	\$24 million	\$25 million	Unknown	\$26.25 million

In sum, it is unclear what taxes will be in 2009, but it seems likely that they will be higher. Hence, for tax-savvy company owners, many will consider a potential sale in advance of the probable capital gain tax hikes.

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### What Can you Do?

The 2008 elections have the potential to bring about major change, with significant implications for the supply chain sector. The risks of Card Check, NAFTA rollbacks and tax hikes all loom large. How should you respond?

First, set your strategy. As market conditions shift, your business plans should reflect new realities. If Card Check goes through, how will you ensure your work force is not at risk? If free trade regulations are re-written, what new responsibilities will your business need to handle? If taxes increase, how will you mitigate the impact?

Second, if you own a company, evaluate your business risks. Smart owners and entrepreneurs understand that timing is everything. 2008 could be a great time to sell, before trade slows, regulatory burdens expand and taxes increase.

Third, if you have an opinion on these legislative issues, get involved in the elections. Choose your candidate. Convey your opinion. Cast your vote.

2008 could be a momentous year for the supply chain sector. Death and taxes may remain inevitable, but with shrewd strategic planning, you can position yourself for success.

### A Supply Chain Scorecard: How the Candidates Compare

	<b>Employee Free Choice Act (Card Check)</b>	<b>100% Screening</b>	<b>NAFTA</b>	<b>Bush Tax Cuts</b>
<b>Barack Obama</b>	<i>Supports.</i> Co-sponsored the bill. Has promised to pass the legislation if elected.	<i>Supports.</i> Voted in favor of 100% screening legislation in the Senate.	<i>Opposes.</i> Has criticized free trade. Wants to renegotiate NAFTA.	<i>Opposes</i> the Bush tax cuts. Seeks a 24% capital gain and dividend rate.
<b>Hillary Clinton</b>	<i>Supports.</i> Co-sponsored the bill.	<i>Supports.</i> Voted in favor of 100% screening legislation in the Senate.	<i>Opposes.</i> Has criticized free trade. Wants to renegotiate NAFTA.	<i>Opposes</i> the Bush tax cuts. Seeks a 20% capital gain and 39.6% dividend rate.
<b>John McCain</b>	<i>Opposes.</i> Voted to block a Senate vote on the bill.	<i>Supports.</i> Voted in favor of 100% screening legislation in the Senate.	<i>Supports.</i> Has advocated encouraging more free trade.	<i>Supports</i> maintaining the Bush tax cuts, including 15% capital gains and dividend rates. Unknown whether he can get Congressional support.



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