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Polymer Advisory

A Publication of the Benesch Polymer Law Group for the Polymer, Plastics and Packaging Industries

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In This Issue...

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Punitive Tariffs Imposed On Foreign Plastic Bag Manufacturers

On January 20, 2004, the U.S. Department of Commerce announced that it will impose provisional tariffs on polyethylene retail carrier bags[1] imported from China, Malaysia and Thailand. The tariffs arise from the Department of Commerce's preliminary investigation, completed in January 2004, which concluded that the subject bags imported from these countries have been sold at less than fair market value and that tariffs are needed to protect U.S. retail carrier bag manufacturers from the subsidized imports.

The investigations were requested in a petition filed on June 20, 2003, by an ad hoc committee consisting of PCL Packaging, Inc., Barrie, Ontario; Sonoco Products Co., Hartsville, SC; Superbag Corp., Houston, TX; Vanguard Plastics, Inc., Farmers Branch, TX; and Interplast Group, Ltd., Livingston, NJ; collectively known as the Polyethylene Retail Carrier Bag Committee (the "Committee"). The original petition requested anti-dumping tariffs ranging from between 35% and 130% for the foreign companies in question.

In its petition the Committee contends that the U.S. industry is being materially injured and is threatened with material injury as imports of the subject bags are sold at less than fair market value. The Committee cites to declining trends in market share, pricing, production levels, profits, sales and utilization of capacity as evidence of damage to the industry. In reviewing the petition, the International Trade Administration determined that these claims were adequately supported by relevant evidence including import data, lost sales, lost revenue and pricing information.

> "...tariffs are needed to protect U.S. retail carrier bag manufacturers from the subsidized imports."

The Department of Commerce's order names 26 companies from China, six from Malaysia and five from Thailand and levies tariffs against each company, on a company by company basis. The tariffs fluctuate greatly from company to company ranging from 0.12% to 122.88%. The tariffs for the Chinese companies range from 0.12% to 57.09%, with the majority facing a 12.71% tariff. The rates for the Malaysian companies vary from 0.14% to 101.74%, and the rates for the companies in Thailand range from 2.84% to 122.88%. In addition, the order includes tariffs for companies in each country that are not specifically named. The unnamed companies face tariffs of 80.52% in China, 84.81% in Malaysia and 11.54% in Thailand.

It is unclear what the effect of the temporary tariffs will be and to what extent it will help U.S. manufacturers recover the lost sales and profits

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that result from the subsidized foreign imports. On an individual company basis, those foreign companies hit with the highest tariffs will experience immediate consequences and will likely be forced to reduce or completely cease exporting plastic bags to the U.S. However, some of the largest exporters of plastic bags will be subject to the smallest tariffs, suggesting the overall impact of the tariffs will be insignificant. Further, until the tariffs are made permanent, the action only helps to delay the effects of the unfairly subsidized foreign imports.

In determining whether final tariffs will be imposed, the Department of Commerce will consider comments from interested parties on its preliminary determinations and evidence that is already on record to determine whether the individual companies sold plastic bags at less than fair market value. Then, the matter will go before the U.S. International Trade Commission, which will consider whether the imports materially harm or threaten to materially harm the U.S. polyethylene retail carrier bag industry. If both agencies establish affirmative determinations, an antidumping order will be issued that will impose final tariffs and instruct U.S. Customs and Border Protection to collect cash deposits for antidumping duties at the specified rates. This final order, should it be issued, is preliminarily scheduled to be signed on August 17, 2004. However, this deadline may be extended.

For further information on this topic, please contact Allan Goldner at 216.363.4623 or by electronic mail at agoldner@bfca.com or Cormac McCarthy at 216.363.4681 or by electronic mail at tmccarthy@bfca.com.

D&O Insurance May Not Offer Enough Protection

Companies in the polymer business that are considering buying directors and officers (D&O) insurance, thinking they will secure a comforting layer of liability protection for their executives, are likely to be in for a rude surprise. D&O insurance often has more gaps in coverage than many polymer business executives would expect. A business should identify those gaps prior to buying a D&O policy. With that knowledge a company will make a better-informed purchasing decision and will be better positioned to manage its risk.

> "D&O insurance often has more gaps in coverage than many polymer business executives would expect."

Who is covered?

Generally all past, present and future directors and officers are covered. The employees and the organization itself may or may not be covered. Find out beforehand who will or will not be covered.

What is covered?

D&O policies cover claims, not occurrences. This means that the policy in effect at the time a claim is made and reported to the insurance carrier will apply, not the policy that was in effect at the time of the events giving rise to the claim.

A claim is generally a written demand for money damages, such as a civil lawsuit. A trap for the unwary is not recognizing that certain criminal, regulatory and administrative proceedings or investigations can also qualify as claims that should be reported promptly to the insurance carrier. Claims not promptly reported can result in the loss of coverage.

Typically, policy benefits are not payable until any self insured retention (similar to a deductible) has been satisfied. That means the company might have to pay some of the defense costs or liability associated with the claim.

To be covered, the claim must assert a "wrongful act" as defined by the policy. However, conduct of a fraudulent or criminal nature typically is excluded, as are claims to recover illegal profit.

One of the more troublesome features of a D&O policy is the allocation provision. It opens the door for the insurance carrier to allocate defense costs and liability payments between covered and uncovered claims. The policyholder is not obligated to accept the carrier's allocation. Disputes may be resolved by alternative dispute resolution.

Finally, a D&O policy's limits of liability (i.e., what it will pay on behalf of an insured) usually are reduced by the amount of defense costs. Because litigation against directors and officers is expensive, coverage can be impaired substantially by large attorney fees and litigation costs.

Proactive steps to take

In short, D&O insurance is not a panacea for the ills faced by today's directors and officers in the polymer field. D&O insurance only should be

1. According to a fact sheet released by the International Trade Administration, polyethylene retail carrier bags are commonly referred to as t-shirt sacks, merchandise bags, grocery bags or checkout bags. The tariffs and the ongoing investigation specifically exclude (1) polyethylene bags that do not have logos or store names printed on them and that are closeable with drawstrings made from polyethylene film and (2) polyethylene bags with printing that refers to specific end uses other than packaging and carrying merchandise from retail establishments (e.g., garbage bags, lawn bags, trash-can liners).

one element of a wider program aimed at claims prevention through proper corporate governance, compliance and decisionmaking.

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Pricing Disparity Between Financial And Strategic Buyers Narrows

The difference between the price financial buyers and strategic buyers are willing to pay for acquisitions has been dramatically reduced and continues to decrease. This includes, but is not limited to, M&A activity in the polymer industry. Included in the definition of a financial buyer are private equity funds, leveraged buyout funds and other institutional investors who are interested in buying, operating and selling companies to generate investment returns. In contrast, strategic buyers are companies who make acquisitions in an effort to increase market share, improve their competitive position, increase operational efficiencies and stimulate future growth.

Precedent has established that strategic buyers are usually willing and able to pay a higher premium for acquisitions than financial buyers, who are less inclined to pay more than fair market value for a company. Two principal factors have caused this historical price gap: 1) strategic buyers have been willing to pay for expected synergistic benefits due to economies of scale and 2) strategic buyers have had greater access to capital (i.e., they could offer stock or a combination of stock and cash to finance a transaction). Today, this precedent no longer holds true, as market dynamics among both strategic and financial buyers are changing their respective pricing tendencies.

Strategic Buyers Reduce Valuation Multiples Yet Deal Activity Remains Strong

Several factors have quelled strategic buyers' fervor to make acquisitions and their readiness to pay premiums for such acquisitions. Although there are signs of economic recovery, business confidence continues to waver. This uncertainty has caused strategic buyers to become more risk averse, as they wait for the economy to stabilize. As a result, strategic buyers remain focused on their core competencies in an effort to survive in a difficult market.

> **Market dynamics among buyers are changing their pricing tendencies**

This risk aversion and the state of the economy have had a two-fold effect on the M&A activity of strategic buyers in the polymer industry. On one hand, the divestiture of the non-core operations has accounted for much of the deal flow in the polymer industry over the past year. On the other hand, these factors have caused strategic buyers to reassess their valuation methods.

Strategic buyers are moving towards the lower end of the value range as they are now adhering more strictly to the types of financial analysis that financial buyers have historically employed. Companies are sensitive to movements in their stock price and are keenly aware of the dilutive effect of overvaluing a target. Thus, the prices many strategic buyers are willing to pay are limited by the market's valuation of a target. This, coupled with the memory of paying for elusive synergies in deals gone bad, has further increased strategic buyers' risk aversion and caused them to be less aggressive with acquisitions. Strategic buyers are no longer willing to pay for synergies that are not immediately realizable.

Further, one of strategic buyers' greatest advantages over financial buyers has become a disadvantage. As stated above, strategic buyers have historically had greater access to capital as they could utilize their own stock to finance a transaction. Today, stock does not buy what it used to and depressed stock prices make for inferior transaction currency. In today's market cash rules, as potential targets are skittish about accepting the possibly overvalued stock of an acquirer.

The overall result is that strategic buyers are no longer willing to pay more than financial buyers for acquisitions. In fact, in some instances strategic buyers are being outbid by their financial buyer counterparts.

Financial Buyers Increase Valuation Multiples and Presence in Polymer Industry

In contrast, several factors are causing financial buyers to become more active in the plastics M&A market and to be more aggressive when pricing deals. The result is a closing of the pricing gap between financial and strategic buyers from the opposite direction. The driving force behind this trend is an abundance of unin-

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vested capital available for financial buyers to invest. Financial buyers are actively seeking opportunities to put this easily accessible money to work. Concurrently, the high yield and leveraged loan markets are flourishing as the cost of borrowing has decreased and the availability of financing has increased.

The availability of capital is augmented by the fact that many financial buyers have formulated investment strategies that specialize in the polymer industry. Private equity firms are creating platforms in appealing niche markets with the desire of combining multiple acquisitions to create a single larger entity. This activity has allowed financial buyers to realize some of the synergistic benefits of economies of scale that previously were exclusive to strategic buyers. As the readily quantifiable synergies available to financial buyers increase, so too has the price that financial buyers are willing to pay for attractive targets.

As the pricing gap between financial and strategic buyers continues to close and the economy shows signs of recovery, it is unclear whether these trends will continue. What is certain, is that financial buyers are assuming a more prominent role in the polymer industry. At least for the time being, this means that potential target companies can no longer assume that they can obtain the highest offering prices from strategic buyers.

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INDUSTRY EVENTS

February 2, 3, and 4, 2004
Allan Goldner, Jim Hill, Ira Kaplan and Megan Mehalko, Polymer Law Group members, presented at *Plastics' News'* 2004 Executive Forum in Las Vegas, Nevada

February 5, 2004
Steve Auvil and Jim Farmer, Polymer Law Group members, presented at *The China Challenge: How to Compete and Win* in Columbus, Ohio, co-sponsored by Benesch, PolymerOhio, Plante & Moran, 889 Global Solutions Ltd. and Bank One

March 10, 2004
Marc Blubaugh, John Fahsbender, Jim Farmer and David Paragas, Polymer Law Group members, presented at our Transportation and Logistics Conference *Maximizing Opportunities and Minimizing Risks in Transportation and Logistics: How the Law Can Help* in Columbus, Ohio

The Benesch Polymer Law Group will host a series of breakfast seminars to discuss PolymerOhio purchasing and shared services coop and M&A trends in the polymer industry on:

April 6, 2004 in Marietta, Ohio
April 23, 2004 in Dayton, Ohio
May 5, 2004 in Columbus, Ohio
May 18, 2004 in Findlay, Ohio
June 6, 2004 in Cleveland, Ohio
June 22, 2004 in Akron, Ohio

April 27, 2004
Ann Knuth, Polymer Law Group member, will present at our 18th Annual Labor and Employment Conference "*The Continuing Evolution of Workplace Regulation*" in Cleveland, Ohio. For additional information and to register for this conference, log on to www.bfca.com/events/labor.asp

April 28, 2004
Ohio Polymer Summit 2004, Columbus, Ohio co-sponsored by the Benesch Polymer Law Group. Jim Farmer, Ginger Mlakar and Megan Mehalko, Polymer Law Group members, will present at the Summit. For additional information and to register for this program, log on to www.polymerohio.org

June 22-24, 2004
Plastics Encounter Midwest, Cleveland, Ohio, co-sponsored by the Benesch Polymer Law Group. For additional information, log on to www.plasticencounter.com

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