

ARTHUR ANDERSEN & CO, SC

**BUSINESS ETHICS
PROGRAM**

The Empire Globe Corporation Case

Business Policy and Economic Analysis

This case was developed by Dr. Clarence Walton and Dr. Edwin M. Epstein. Arthur Andersen & Co, SC thanks the authors for their substantial contributions to the Business Ethics Program.

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Arthur Andersen & Co, SC has sponsored and funded this project to promote discussion and awareness of ethical issues arising in the business world. Arthur Andersen & Co, SC takes no positions and expresses no views with respect to the myriad of ethical issues reflected in this case but hopes that users will facilitate and promote a dialogue on these important issues.

EMPIRE GLOBE CORPORATION

SITUATION I

Overview

This case presents a developing situation encountered by Susan Bond, a recent MBA graduate now working as a corporate economist for the Empire Globe Corporation. This situation arises when senior management at Empire announce that for “economic” reasons they are considering moving their operations out of the town of Feldport unless several concessions can be obtained from the local constituents.

Susan Bond’s involvement in Empire Globe's negotiations with local political, business, and union representatives in Feldport challenges her professional integrity and forces her to reevaluate the company’s “partnership” philosophy. As a key member of the negotiating team and as one of Empire Globe’s economic advisors, Susan Bond finds herself in a difficult position.

Key Players

John Treadstone - After completing his degree in chemical engineering, Treadstone joined Empire Globe in the summer of 1955. Hard work and dedication to corporate and civic duties earned him the CEO position by 1973. While deeply aware of his fiduciary responsibilities, Treadstone remained firmly convinced that the legal definition of his managerial responsibilities, provided him by corporate counsel, constituted only the foundations upon which a more sophisticated concept of his obligations could be constructed.

It didn’t take long as CEO for Treadstone to realize that managing relationships within his organization is as important as managing external relationships. Conflicting motives and interests within organizations such as Empire Globe are inevitable. Stockholders, managers, trustees, and the CEO all have agendas and objectives which are not shared consistently. Such divergences of interest must be kept to a minimum. Minimizing, however, means policing, and policing means costs. Treadstone knew that by reducing these costs, Empire Globe could gain a significant competitive advantage. The best way to reduce these costs is by creating an atmosphere of trust. This one word led Treadstone to articulate the corporate philosophy: “Partners who trust one another prosper.”

To Treadstone, extending this “partnership” to those parties outside of, yet affected by, Empire was logical and natural. So as Empire grew, Treadstone fostered this sense of trust and cooperation with his management team, his employees, and the communities where Empire Globe engaged in business.

Shortly after his appointment as CEO, Treadstone appointed a Partnership Conduct Team (PCT) consisting of four experienced managers. The team was charged with the tasks of:

- Drafting ethical guidelines that would go beyond the requirements of the law to define the company’s behavior around the world,
- Developing a practical way to monitor and to report the company’s business operations and practices, and

- Recommending ways to prevent ethical/legal slippage.

Stressed consistently to the PCT was Treadstone's conviction that a partnership philosophy meant that partners had to be involved in decisions affecting their vital interests, had to be treated equitably, and had to share in the costs and benefits of local operations. Without such treatment, the partnership would soon dissolve.

One result of the PCT's efforts was the establishment of schedules to provide for regular visits to the company's operations. Initially, field managers felt that PCT visits represented a hidden agenda. Was the local enterprise in trouble with the government? Had a colleague squealed to headquarters about something or other? Were bribes being taken--or given? Were there informants assigned to various plants? Sensing these fears, the PCT sought to establish a basis of trust between field and headquarters.

Susan Bond - She considers herself fortunate to have landed a position with a firm such as Empire Globe. As one of the leaders in its industry, Empire offered career opportunities many of her fellow graduates could only dream of. Economics aside, Susan was attracted by a firm with such a noteworthy reputation among the business community and the general public. Treadstone's articulation of the company's "philosophy" struck a significant chord with her.

Fresh out of graduate business school (the same university her CEO John Treadstone attended), Bond is bright, eager, yet still a bit insecure about her role at Empire Globe. Still, she knows what she wants and pursues it with determination. Even though she's been at Empire for less than a year, her skills and sense of professionalism have won Treadstone's confidence. Treadstone created the Corporate Economist position so he could have someone like Bond help him identify looming economic problems and interpret the economic validity of major reports and proposals. Officially, Bond reports to the VP of Finance, Jim Doran, but functionally she serves as consultant to the CEO and the other members of senior management. She has no vested interest or commitment to any department, person, or group. Treadstone uses her feedback to analyze and question the information he receives from senior managers. In this sense, Susan Bond acts as a "filter" for her CEO and a liaison to the rest of senior management.

Susan has several remarkable qualities useful to Treadstone. She knows how to read people as well as financial statements. She knows how to watch, how to listen, and how to remember every detail of what she sees and hears. Above all, Susan knows how to keep her mouth shut. Shrewd and cultivated, Susan would inevitably be in line for promotion to a top job. Susan is capable of doing a first rate job in both economic analysis and finance. Knowledge of her skills is bound to spread throughout the industry, and Treadstone wants to be sure he will not lose her. Assuring her of the opportunities Empire can provide is the best way to prevent that possibility.

Jim Doran - Vice President of Finance and a twenty- year veteran of Empire Globe, Jim is respected throughout the firm as a financial genius, yet his surly demeanor often restricts his work relationships to just that--respect. For some reason, however, he and Treadstone are almost inseparable. Perhaps it is because Treadstone understands his own limitations as the "chemical engineer" in charge of Empire. It is certainly true that Doran understands those limitations.

Ted Bates - A senior financial analyst under Jim Doran, Ted believes he has reached the limits of his career path at headquarters. Several opportunities for promotion have come and gone with no result. Frustrated and somewhat bitter, Ted has become increasingly vocal in his displeasure and belligerent towards his superiors.

The Community

Feldport was once a thriving community. Two hospitals provided good medical care; two public high schools and three small parochial institutions served the community's educational needs. Three small refining facilities, an automotive assembly plant, a modest manufacturing plant run by Cove Industries, and a large railroad yard provided employment opportunities sufficient to meet the needs of the local labor market.

Powerful and vocal unions had extracted so many concessions from employers that Feldport was seen as a tough union town.

By the mid 1960s, however, several economically distressing developments caused Feldport to fall upon hard times. Two of the refining operations had all but closed; the automotive assembly plant was relocated to a city 300 miles distant; the railroad terminal was much smaller as Mack trucks had successfully challenged diesel engines; union muscle had weakened considerably. The result: A once thriving community had entered what was to be an extended period of economic and civic stagnation.

The Company

Founded in 1947 as a result of a 50/ 50 joint venture between the Empire Chemical Company and Globe International, Empire Globe has grown to become an industry leader. A diverse line of products and significant processing and distribution networks worldwide require Empire Globe to employ approximately 3,000 individuals. Many of Empire Globe's employees are well trained in computer technology, and the natural sciences, especially chemistry. Regular investment in research and development has paid off handsomely in the form of numerous patents and several rather unique commercial products. Unlike the common divisionalized structure, Empire Globe has what it calls a "matrix system." On one axis are the functional units: production/ distribution, marketing, finance, R& D, and human resources. Along another axis are the different product lines. The third dimension of Empire Globe's matrix are the geographical areas, which contain both functional and product groups. When serious problems or promising opportunities arise unexpectedly, senior management quickly identifies the product/ functional areas most directly involved and, from them, establishes an ad hoc working group (task force) to analyze the situation and make recommendations to the CEO.

In the 1970s, Empire Globe's research team developed a new product they chose to call "Polerone," after the project's technical name, Polymer R- 1. Polerone is a highly versatile hybrid polymer that can be used in a variety of ways: as a coating, as a processing lubricant, or as an integral design material. It has been successfully and profitably- adapted as a key ingredient in the formulation of commercial paints and construction materials, as well as in the manufacture of electronic circuitry. Since the manufacture of Polerone requires a mixture of minerals, petroleum, sand, and quartz, it is important for Empire Globe to have reliable sources of supply. Although available elsewhere, these resources were initially obtained in Brazil, Uruguay, and Chile. Long- term contracts were concluded with mining companies in each of the respective countries.

Efforts with Polerone went surprisingly well until the late 1970s, when an Empire Globe task force made a startling and disturbing discovery: the sources of supply in the three countries were not nearly so ample or reliable as originally estimated. Treadstone could well remember the way he winced in shock and frustration when the news was brought to him and how the final two sentences of the task force report had been etched in his mind: "In short, Empire Globe cannot rely on a steady supply of those essential raw materials from overseas sources. Shortages, coupled with increasingly unstable political conditions, make it imperative that our company move quickly to acquire a manufacturing facility near a domestic source of supply."

Not given to delays, Treadstone established a study group with orders to identify domestic areas that might meet company needs and to produce a report to be in his hands within six weeks. Three small communities-- Glebe in Arizona, Gerard in Missouri, and Feldport in Oklahoma- were identified.

Detailed economic development reports were prepared on each location and then visitations were conducted to view such externalities as schools, recreation facilities, labor availability, political stability, potential involvement by the local investment community, and the like. The visitation team members who accompanied Treadstone on the three visits were asked to prioritize locations---and Feldport came in a distant third. But something intrigued Treadstone about Feldport. Job opportunities were scarce and job hunger was high; the old union truculence had vanished as prosperity had faded; a citizens' reform movement had cleaned up City Hall; the largest local bank had a "live wire" president; the Cove Industries factory was for sale; space needed for a modest railroad siding and a trucking facility adjacent to the factory might be easily available; a good rail spur ran up to the main line; an interstate throughway skirted the edge of Feldport; and--above all--Feldport's leaders expressed the willingness to do everything possible to make Empire Globe a part of their community. Obviously, other items had to be checked at all three locations, but even when the more detailed study was evaluated, Treadstone clung to his original position: Feldport was the place to go.

The Cove plant employed approximately 100 workers on a three-shift day. Treadstone saw this plant as employing a minimum of 300 workers, a view that encouraged everyone concerned with Feldport's future.

The Cove Industries facility should be purchased for several reasons:

- The acquisition price for the facility was right.
- Space for shipping and storage was available adjacent to the facilities in a neighborhood referred to locally as "Littown." This area was populated primarily by the semiskilled laborers employed by Cove Industries. Such an area could be obtained for a song if city officials would only exercise their powers of eminent domain.
- Even if this approach failed, the purchase price was relatively low.

His decision reinforced Treadstone's belief that Feldport was the optimal community in which to locate. After jotting down his reasons, Treadstone gave them a final check:

- Feldport had an ample labor pool eager for steady work.

- The city officials and local businesses were clearly willing--even anxious--to make whatever special arrangements were deemed necessary to attract Empire Globe. Feldportians were stable, hardworking, and honest. Locating the plant in Feldport would ensure consistent levels of production and allow Empire Globe to experiment, test, and eventually improve the quality of Polerone.
- Reasonable power rates currently community were available from the Crystal Creek Power Authority (CCPA) would offset anticipated rising freight costs.

Having completed his last appraisal, Treadstone looked at Feldport as a whole and liked what he saw. Treadstone decided he would override the task force recommendation--something he had done only on the rarest of occasions and never when the task force was unanimous in its opinion.

Consistent with Empire Globe's partnership philosophy, Treadstone sought involvement by the community itself. The company received a large loan at an interest rate 1 percent below prime; granted the company real estate tax-free status for five years; a renegotiated union contract contained a no- strike clause; relatively low energy costs were all but promised by the CCPA. Practically everything that Empire Globe wanted, Empire Globe got. In return--again, inline with the corporate philosophy--Empire Globe pledged publicly to treat the various participants in the new venture as partners--not simply participants. The practical expression of the "partnership" involved a sharing of views on all critical decisions affecting the future of the company and the community.

In addition, through Empire Globe, Treadstone helped to arrange the financing to build public housing for the residents of the "Littown" neighborhood displaced by the company's acquisition of ten acres adjacent to the Cove Industries plant. Empire also donated \$250,000 for renovations to one of the oldest churches in town.

Early evidence of financial success (10 percent return on capital) plus the continued growth of solid relationships between Empire Globe and the community were tangible evidences that Treadstone's choice of communities had been a good one.

The Setting

During the first five years of Empire Globe's presence in Feldport, "things" looked great. On paper, Treadstone's original hunch to establish an operation in Feldport appeared to be sound. Return on capital was good, as it needed to be for such a capital-intensive operation. However, this was due largely to the original concessions Empire Globe negotiated with members of the local government and business community. Once the contract for the original concessions expired and new agreements were reached, profit margins slowly, steadily, and noticeably began to trail off. Treadstone was quite agitated. He often verbalized his displeasure with the fact that operations in Feldport were rather "ho-hum" in their performance.

Since contracts and agreements established for the second five-year period of Empire Globe's presence in Feldport were expiring, negotiations were resumed. To address this task, Treadstone identified a task force and charged the members with the responsibility of formulating strategies to be used and goals to be achieved by a negotiating team of their choice.

In addition, Treadstone emphasized that operations in Feldport would likely be discontinued unless the following five objectives were met:

- 1) The City of Feldport would grant an armistice on real estate taxes. At a minimum, they must agree to a maximum increase of 3 percent, held constant for the next four years.
- 2) Union representatives would renegotiate the three-year contract which then had a year to run, and with the clear understanding that their total compensation package would only increase 8 percent (subject only to an annual adjustment cap based on 90 percent of the CPI index). In addition, the new contract would contain a no-strike clause similar to the original agreement between Empire Globe and the unions.
- 3) The Feldport First National Bank would renegotiate with Empire Globe to provide a second loan at one percent below the prime rate.
- 4) Trucking rates for Empire Globe would be held fixed, based on present rate schedules and subject only to an annual adjustment cap based on 90 percent of the ICC index.
- 5) The Crystal Creek Power Authority would agree to a rate increase not to exceed 4.25 cents per kwh (subject only to 3 percent annual adjustment).

Treadstone was so strong in his conviction that concessions must be promptly made that in a recent press conference he stated: "If the concessions aren't obtained, return on capital at Feldport will become such that I will be forced to move the production facilities to another location--either here in the U.S. or abroad through a joint venture."

Susan's Dilemma

As a key member of the negotiation team, Susan Bond has been spending a lot of time in Feldport. In Jim Doran's absence, Susan has assumed many of his responsibilities as lead negotiator. A willing ambassador for Empire Globe, she has been working very closely with community leaders to secure the concessions Treadstone declared essential for operations to remain in Feldport.

So far, four of the five objectives outlined in her negotiation plan book have been met. The city officials and bankers readily agreed to a cap on real estate taxes and below-market interest rates on financing needs. The truckers reluctantly agreed to "hold the line" on tonnage rates. After a long and heated debate, the union finally conceded to a new three-year contract. Susan was surprised at how far the town was willing to bend to keep Empire Globe around:

In fact, Susan has become quite troubled both with the demands her employer has made upon the community and with her success in fulfilling them. Individually, these concessions seemed reasonable, but as a package they struck her as being excessive. Were all the concessions absolutely necessary for the Feldport plant to operate at an acceptable rate of return? Has Empire Globe made any commitment whatever? The balance of the "partnership" seemed to tilt almost entirely in favor of Empire Globe, and it was not the kind of "partnership" described to her as a new hire. It was in this frame of mind that Susan finished her preparations for the final round of negotiations--with the Crystal Creek Power

Authority (CCPA). The rest of the company's negotiating team would arrive in the morning, and talks would begin after lunch. Susan Bond wasn't looking forward to this last round.

Tired and anxious, Susan was about to call it a day when a mail room courier delivered a telex from World Headquarters to her. The front was marked "Urgent and Confidential." Susan read its terse message:

///BEGIN MESSAGE///

"CONFIDENTIAL"

FROM: JOHN TREADSTONE

TO: SUSAN BOND (FOR YOUR EYES ONLY)

RE: CCPA RATE NEGOTIATION

NEITHER JIM DORAN NOR MYSELF WILL BE PRESENT AT TOMORROW'S MEETING. URGENT CLIENT BUSINESS REQUIRES OUR ATTENTION IN WASHINGTON D.C. YOU'RE ON YOUR OWN. ONE CHANGE IN STRATEGY: GO FOR RATE CEILING OF 3.80 CENTS PER KWH, NOT 4.25 AS OUTLINED IN PLAN BOOK. THIS IS FIRM.

GOOD LUCK. J.T.

///END MESSAGE///

Susan shook her head. The rate of 4.25 per kwh had seemed low to begin with. The new rate demanded in Treadstone's telex shocked her. How could she possibly support it? Too tired to think anymore, Susan closed her briefcase and dejectedly headed for her car.

EXHIBIT 1

ELECTRIC ENERGY PRODUCTION

SOURCE OF ENERGY: 1960-1986

PERCENT OF TOTAL ENERGY USED - PRIME U.S. MOVERS

YEAR	<u>Total</u>	<u>Coal</u>	<u>Nuclear</u>	<u>Oil</u>	<u>Gas</u>	<u>Hydro</u>
1960	100.0	53.3	0.1	6.4	20.9	19.3
1970	100.0	46.0	1.4	12.1	24.3	16.2
1975	100.0	44.6	9.0	15.2	15.6	15.6
1980	100.0	51.0	11.0	10.8	15.1	12.1
1981	100.0	52.7	11.9	8.9	15.1	11.4
1982	100.0	53.4	12.6	6.6	13.6	13.8
1983	100.0	54.8	12.7	6.2	11.9	14.4
1984	100.0	55.9	13.6	4.9	12.3	13.3
1985	100.0	56.8	15.5	4.0	11.8	11.9
1986	100.0	55.8	16.6	5.5	10.0	12.1

Sources: U.S. Federal Power Commission, Electric Power Statistics (1960-1970). U.S. Energy Information Administration (1975-1980). "Power Production, Fuel Consumption and Installed Capacity" (1981-1986). "Electric Power Annual" and "Annual Energy Review."

U.S. ELECTRIC UTILITY SALES AND AVERAGE PRICES
BY END-USE SECTORS: 1976 TO 1986

AVERAGE PRICE OF ELECTRICITY SOLD (cents per kwh)

YEAR	<u>SALES (bil. kwh)</u>				<u>Current Dollars</u>				<u>Constant(1982) Dollars (**)</u>			
	<u>Total</u>	<u>Resi- dential</u>	<u>Com- mercial</u>	<u>Indus- trial</u>	<u>Total(*)</u>	<u>Resi- dential</u>	<u>Com- mercial</u>	<u>Indus- trial</u>	<u>Total(*)</u>	<u>Resi- dential</u>	<u>Com- mercial</u>	<u>Indus- trial</u>
1976	1,855	606	425	754	3.09	3.73	3.69	2.21	4.90	5.91	5.85	3.50
1977	1,948	645	447	786	3.42	4.05	4.09	2.50	5.08	6.02	6.08	3.71
1978	2,018	674	461	809	3.69	4.31	4.36	2.79	5.11	5.97	6.04	3.86
1979	2,071	683	473	842	3.99	4.64	4.68	3.05	5.08	5.90	5.95	3.86
1980	2,094	717	488	815	4.73	5.36	5.48	3.69	5.52	6.25	6.39	4.31
1981	2,147	722	514	826	5.46	6.20	6.29	4.29	5.81	6.60	6.69	4.56
1982	2,086	730	526	745	6.13	6.86	6.86	4.95	6.13	6.86	6.86	4.95
1983	2,151	751	544	776	16.30	7.18	7.02	4.96	6.06	6.91	6.76	4.77
1984	2,278	778	578	841	6.52	7.54	7.33	5.04	6.03	6.98	6.78	4.86
1985	2,310	791	609	825	6.71	7.79	7.47	5.16	6.02	6.99	6.70	4.83
1986	2,351	818	642	808	6.40	7.41	7.13	4.87	5.59	6.48	6.23	4.28

* Includes other sectors not shown separately.

** Based on the GNP implicit price deflator.

Source: U.S. Energy Information Administration.

CRYSTAL CREEK POWER AUTHORITY
COMPARATIVE INCOME ACCOUNTS
(in thousands of dollars)

EXHIBIT III

	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>	<u>1981</u>	<u>1980</u>
Total Operating Revenue	<u>\$350,378</u>	<u>\$341,012</u>	<u>\$356,191</u>	<u>\$329,517</u>	<u>\$316,060</u>	<u>\$307,752</u>	<u>\$262,764</u>
Operating Expenses	217,341	228,444	217,831	205,817	191,151	178,988	177,057
Maintenance	19,625	18,175	18,171	15,818	14,113	12,369	9,660
Depreciation	23,125	21,655	21,173	20,221	19,531	19,500	17,271
Income Taxes	27,931	16,538	14,955	16,678	11,285	(13,251)	(2,149)
Deferred Income Taxes	815	(465)	3,847	2,181	11,499	33,834	10,212
Investment Tax Credit Adjust., Net	(1,085)	1,914	3,089	570	(771)	(6,415)	4,588
General Taxes	11,067	11,930	16,016	14,965	14,286	14,247	12,389
Amortization of Property Losses	13,789	17,169	17,909	13,490	8,175	26,808	-
Loss from Utility Plant Disposition	<u>5</u>	<u>5</u>	<u>-</u>	<u>5</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Operating Revenue Deductions	<u>312,613</u>	<u>315,364</u>	<u>312,989</u>	<u>289,743</u>	<u>269,268</u>	<u>266,080</u>	<u>229,027</u>
Net Operating Revenue	<u>37,765</u>	<u>25,648</u>	<u>43,202</u>	<u>39,774</u>	<u>46,792</u>	<u>41,672</u>	<u>33,737</u>
Other Income, Net Allowance for Other Funds	618	1,365	(949)	1	1,926	3,039	4,980
Used During Construction	<u>3,584</u>	<u>5,900</u>	<u>5,048</u>	<u>2,615</u>	<u>1,139</u>	<u>5,645</u>	<u>7,152</u>
Gross Income	<u>41,967</u>	<u>32,912</u>	<u>47,302</u>	<u>42,390</u>	<u>49,857</u>	<u>50,355</u>	<u>45,869</u>
Interest on Long-Term Debt	16,039	18,331	18,006	17,546	16,416	24,112	19,951
Amortization - Debt Discount	84	85	82	83	77	78	90
Other Interest Charges	(791)	1,833	2,626	1,049	2,704	2,004	2,607
Allowance for Borrowed Funds Used During Construction	<u>(2,596)</u>	<u>(3,667)</u>	<u>(3,348)</u>	<u>(1,637)</u>	<u>(2,224)</u>	<u>(5,785)</u>	<u>(5,670)</u>
Total Income Deductions	<u>12,737</u>	<u>16,581</u>	<u>17,366</u>	<u>17,041</u>	<u>16,972</u>	<u>20,408</u>	<u>16,978</u>
Net Income	<u>\$29,230</u>	<u>\$16,331</u>	<u>\$29,936</u>	<u>\$25,349</u>	<u>\$32,885</u>	<u>\$29,947</u>	<u>\$28,891</u>

EXHIBIT IV

CRYSTAL CREEK POWER AUTHORITY
OPERATING STATISTICS

	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>	<u>1981</u>	<u>1980</u>
ELECTRIC							
Population served, retail	<u>516,500</u>	<u>549,000</u>	<u>512,500</u>	<u>510,000</u>	<u>500,000</u>	<u>492,000</u>	<u>481,500</u>
Customers (Average):							
Residential	195,369	195,804	194,064	190,149	186,669	182,319	177,099
Commercial	19,088	18,905	18,514	17,922	17,379	16,765	16,285
Small Industrial	9,428	9,516	9,084	10,669	9,830	9,574	9,321
Large Industrial	4	4	3	3	3	3	2
Other	<u>674</u>	<u>833</u>	<u>848</u>	<u>874</u>	<u>858</u>	<u>901</u>	<u>855</u>
Total Customers	<u>224,562</u>	<u>225,062</u>	<u>222,13</u>	<u>219,617</u>	<u>214,740</u>	<u>209,561</u>	<u>203,561</u>
Sales, Kilowatt hours (in 000s):							
Residential	2,013,020	2,008,354	2,004,817	1,932,997	1,891,367	1,817,655	1,884,864
Commercial	1,647,017	1,619,640	1,575,214	1,449,748	1,471,063	1,363,241	1,475,111
Small Industrial	1,220,012	1,116,141	1,145,610	1,104,570	1,120,810	1,136,034	1,065,358
Large Industrial	732,007	777,427	716,006	690,356	630,456	605,885	491,704
Other	<u>488,005</u>	<u>906,999</u>	<u>1,718,415</u>	<u>1,725,890</u>	<u>1,891,367</u>	<u>2,650,747</u>	<u>3,278,025</u>
Total Sales (Kwhs)	<u>6,100,062</u>	<u>6,478,562</u>	<u>7,160,062</u>	<u>6,903,562</u>	<u>7,005,062</u>	<u>7,573,562</u>	<u>8,195,062</u>
Revenues:							
Residential	\$139,985,431	\$130,121,260	\$125,742,136	\$116,656,382	\$107,978,119	\$90,537,384	\$80,031,332
Commercial	103,589,768	94,590,561	90,278,323	80,416,647	78,944,003	64,751,497	60,192,497
Small Industrial	52,649,631	47,218,218	45,376,460	43,452,673	44,566,999	36,960,874	29,397,489
Large Industrial	28,625,149	28,512,149	25,679,561	24,598,080	21,191,404	17,874,817	12,306,852
Other	<u>25,527,537</u>	<u>40,570,048</u>	<u>69,114,642</u>	<u>64,392,970</u>	<u>63,379,695</u>	<u>97,626,995</u>	<u>80,836,087</u>
Total Revenues	<u>\$350,377,516</u>	<u>\$341,012,236</u>	<u>\$356,191,121</u>	<u>\$329,516,752</u>	<u>\$316,060,221</u>	<u>\$307,751,566</u>	<u>\$262,764,256</u>
Kilowatt Hrs Generated (Net)	6,097,821,562	6,631,579,062	7,283,569,062	7,250,563,562	7,423,133,562	8,143,688,562	8,689,310,562
Kilowatt Hrs Purchased (Net)	<u>439,559,562</u>	<u>341,966,562</u>	<u>370,158,062</u>	<u>154,734,562</u>	<u>23,333,062</u>	<u>14,340,062</u>	<u>46,731,062</u>
Total Kilowatt Hours	<u>6,537,381,123</u>	<u>6,973,545,623</u>	<u>7,653,727,123</u>	<u>7,405,298,123</u>	<u>7,446,466,623</u>	<u>8,158,028,623</u>	<u>8,736,041,623</u>

EMPIRE GLOBE
NEGOTIATION PLAN BOOK - FELDPOR PLANT
1987 PRICING STRATEGIES

	CURRENT SCENARIO				NEGOTIATING TARGETS			
	<u>RATE OF MEASURE</u>	<u>PRESENT FELDPOR RATES</u>	<u>PRESENT FELDPOR COSTS</u>	<u>PRESENT ECONOMIC VALUE</u>	<u>RATE OF MEASURE</u>	<u>TARGET FELDPOR RATES</u>	<u>PROJECTED FELDPOR COSTS</u>	<u>FIRST YEAR ECONOMIC VALUE</u>
<u>ISSUES:</u>								
<u>REAL ESTATE TAXES:</u>	Mils per assessed valuation	0.23455	\$295,436	\$325,000	Mils per assessed valuation	0.24159	\$304,299	\$346,125
<u>COMMENTS:</u>	<u>Rate held steady for last 4 years.</u>				<u>Rate to hold for 4 years.</u>			
<u>BANK FINANCING:</u>	% v. Prime based on credit line usage	-1	\$2,350,000	\$2,674,004	% v. Prime based on credit line usage	-1	\$2,750,000	\$3,118,880
<u>COMMENTS:</u>	<u>Rate subject to utilization minimums.</u>				<u>No utilization minimums.</u>			
<u>TRUCKING RATES:</u>	Rate per tonnage shipped	Rate Schedule	\$4,200,000	\$4,536,000	Rate per tonnage shipped	Rate Schedule	\$4,326,000	\$4,929,498
<u>COMMENTS:</u>	<u>Rate subject to ICC cost adjust index.</u>				<u>Rate subject to 90% ICC cost adjustment index.</u>			
<u>UNION RATES:</u>	Hourly Cost	\$17.53	\$5,469,360	\$6,125,683	Hourly Cost	\$18.93	\$6,299,904	\$7,181,891
<u>COMMENTS:</u>	<u>Rate subject to CPI inflator index adjustment.</u>				<u>Rate subject to 90% CPI inflator index adjustments.</u>			
<u>POWER RATE:</u>	Kwh's	3.53	\$8,384,881	\$10,516,111	Kwh's	4.25	\$10,593,261	\$11,428,384
	<u>Rate subject to automatic 2.5% annual adjustment.</u>				<u>Rate subject to automatic 3.0% annual adjustment.</u>			
<u>SUBJECT COSTS TO NEGOTIATION:</u>			<u>\$20,699,677</u>	<u>\$24,176,798</u>			<u>\$24,273,464</u>	<u>\$27,004,778</u>
<u>% NEGOTIATED COSTS/ECONOMIC COSTS:</u>			<u>85.62%</u>				<u>89.89%</u>	

EXHIBIT VI

EMPIRE GLOBE - FELDPOR PLANT

CRYSTAL CREEK POWER AUTHORITY

	<u>Kilowatts Purchased By Empire Globe (in 000s)</u>	<u>CCPA Charges (cents per Kwh)</u>	<u>Power Cost</u>	<u>Kilowatts Sold To Empire Globe (in 000s)</u>	<u>Large Industrial General Rate (cents per Kwh)</u>	<u>General Rate Power Revenue Applicable to Empire Globe</u>	<u>Concession to Empire Globe Feldport Plant</u>
Actual							
1980	177,782	2.50 (1)	\$4,444,539	177,782	2.68	\$4,761,364	\$316,825
1981	182,340	2.50 (1)	4,558,502	182,340	3.16	5,755,565	1,197,063
1982	186,061	2.50 (1)	4,651,533	186,061	3.77	7,007,813	2,356,280
1983	197,938	3.20 (1)	6,334,002	197,938	3.81	7,546,191	1,212,189
1984	206,185	3.28 (1)	6,762,867	206,185	3.84	7,913,564	1,150,698
1985	217,037	3.36 (1)	7,2%,777	217,037	3.92	8,518,174	1,221,396
1986	226,080	3.45 (1)	7,790,830	226,080	4.18	9,460,928	1,670,098
Estimate							
1987	237,384	3.53 (1)	\$8,384,881	237,384	4.43	\$10,516,111	\$2,131,231
Projections (3)							
1988	249,253	4.25 (1)	\$10,593,261	249,253	4.59	\$11,428,384	\$835,123
1989	261,716	4.38 (1)	11,456,612	261,716	4.75	12,419,7%	963,184
1990	274,802	4.51 (1)	12,390,326	274,802	4;91	13,497,213	1,106,888
1991	288,542	4.64 (1)	13,400,137	288,542	5.08	14,668,097	1,267,960
1992	302,%9	4.78 (1)	14,492,248	302,969	5.26	15,940,554	1,448,306

(1) Negotiated fixed rate

(2) Negotiated rate - first-year of 3.2 cents per Kwh with 2.596 annual adjustment after first year.

(3) Assumes annual 5% growth in accordance with normal business planned growth.

(4) Under negotiation - first-year rate of 4.25 cents per Kwh with 3.96 annual adjustment after first year, as per strategies in Empire-Globe Negotiation Plan Book.

EXHIBIT VII

EMPIRE GLOBE - FELDPOR PLANT
INCOME STATEMENTS (in thousands of dollars)

	FORECAST ESTIMATE		ACTUAL				
	<u>1988</u>	<u>1987</u>	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
SALES REVENUES	<u>\$72,900</u>	<u>\$67,000</u>	<u>\$62,328</u>	<u>\$57,646</u>	<u>\$53,008</u>	<u>\$49,279</u>	<u>\$42,798</u>
COSTS:							
MATERIALS AND SUPPLIES	\$25,880	\$24,300	\$22,999	\$21,387	\$19,719	\$18,430	\$16,007
POWER	10,600	8,400	7,791	7,297	6,763	6,334	4,652
CONTRACT LABOR	6,300	5,500	5,111	4,669	4,241	3,992	3,509
TRUCKING	4,330	4,200	3,927	3,689	3,446	3,252	2,867
SALES SERVICE 1,281	1,220	1,122	1,095	1,007	1,035	856	
REPAIR AND MAINTENANCE	2,646	2,450	2,244	2,075	1,908	1,774	1,541
RESEARCH & DEVELOPMENT	925	1,200	1,500	1,525	1,475	1,440	895
GENERAL ADMINISTRATION	1,025	920	800	780	820	775	770
INTEREST EXPENSE	2,750	2,350	1,780	1,450	1,280	1,260	1,160
OTHER	<u>830</u>	<u>755</u>	<u>645</u>	<u>725</u>	<u>660</u>	<u>710</u>	<u>680</u>
	56,567	51,295	47,918	44,693	41,319	39,002	32,937
ADD: DEPRECIATION	<u>15,600</u>	<u>15,500</u>	<u>14,000</u>	<u>12,500</u>	<u>11,250</u>	<u>9,875</u>	<u>9,450</u>
TOTAL COSTS	<u>72,167</u>	<u>66,795</u>	<u>61,918</u>	<u>57,193</u>	<u>52,569</u>	<u>48,877</u>	<u>42,387</u>
INCOME BEFORE INCOME TAXES	<u>\$734</u>	<u>\$705</u>	<u>\$410</u>	<u>\$453</u>	<u>\$440</u>	<u>\$402</u>	<u>\$411</u>

EMPIRE GLOBE CORPORATION

SITUATION II

Something strange was going on back at World Headquarters. Susan sensed it, but she didn't have enough information to know what it was. Trusting her intuition, she canceled the afternoon meeting with the CCPA and called Ted Bates, a senior colleague in finance.

SUSAN: I'm doing a little research, Ted, and I was hoping you might be able to help. You have a few minutes?

TED: Sure. What's up?

SUSAN: You know the deal we're trying to cut with the Power Authority here in Feldport...?

TED: Yeah

SUSAN: Well, yesterday I got a telex from Treadstone informing me that our new rate ceiling was 3.8 cents per kwh--down from 4.25.

TED: Right

SUSAN: You're not surprised? Ted, you know utilities inside and out...

TED: Well, I know, but Jim Doran had me running some production efficiencies with that number earlier this week.

SUSAN: Really. That's interesting. I did my homework, and I can't see how our current level of production could possibly justify such a low rate. Can you?

TED: I'm not sure, but from what Doran was telling me, production at Feldport will be increasing significantly... 25 percent or so.

SUSAN: Twenty-five percent?! How does he figure that?

TED: I guess that big contract with the Department of Defense is almost finalized. He and Treadstone are supposed to be signing the dotted line today.

SUSAN: So that's why they couldn't make it for our negotiating session--which I canceled.

TED: You did?

SUSAN: Uh-huh. I didn't feel I could argue for such a lower rate without more data to justify our position. Now I see what's going on.

TED: Well, good luck.

SUSAN: Thanks, Ted. You've been a big help.

TED: No problem. But Susan.... off the record, eh?

SUSAN: Don't worry. Talk to you later.

TED: Okay. Bye.

When Susan hung up the phone, she was shaking. How long had her superiors been working on this new contract? Why hadn't they told her? And why had they threatened to close the Feldport plant if they knew production was going to rise so sharply? Her instincts had been right. Something out of the ordinary was going on.

Carefully, Susan ran through several calculations. The new projections based on a 25 percent increase in output from the defense contract were staggering. Profits generated by the Feldport plant would exceed all of the company's earlier expectations. Susan felt she had been used. The negotiation process now seemed like a ploy to take advantage of an unsuspecting party. At best it was manipulative; at worst, it was dishonest. Perhaps this "partnership" philosophy was merely a clever way to rationalize greed. Susan felt compelled to do something.

EMPIRE GLOBE - FELDPORT PLANTCRYSTAL CREEK POWER AUTHORITY

	<u>Kilowatts Purchased By Empire Globe (in OOs)</u>	<u>CCPA Charges (cents per Kwh)</u>	<u>Power Cost</u>	<u>Kilowatts Sold To Empire Globe (in OOs)</u>	<u>Large Industrial General Rate (cents per Kwh)</u>	<u>Power Revenue Applicable to Empire Globe</u>	<u>General Rate Concession to Empire Globe Feldport Plant</u>
Actual							
1980	177,782	250 (1)	\$4,444,539	177,782	2.68	\$4,761,364	016,825
1981	182,340	2.50 (1)	4,558,502	182,390	3.16	5,755,565	1,197,063
1982	186,061	2.50 (1)	4,651,533	186,061	3.77	7,007,813	2,356,280
1983	197,938	3.20 (2)	6,334,002	197,938	3.81	7,546,191	1,212,189
1984	206,185	3.28 (2)	6,762,867	206,185	3.84	7,913,564	1,150,698
1985	217,037	3.36 (2)	7,296,777	217,037	3.92	8,518,174	1,221,396
1986	226,080	3.45 (2)	7,790,830	226,080	4.18	9,460,928	1,670,098
Estimate							
1987	237,384	3.53 (2)	\$8,384,881	237,384	4.43	\$10,516,111	\$2,131,231
Projections (3)							
1988	249,253	3.80 (4)	\$9,471,622	249,253	4.59	\$11,428,384	\$1,956,762
1989	261,716	3.91 (4)	10,243,559	261,716	4.75	12,419,796	2,176,237
1990	274,802	4.03 (4)	11,078,409	274,802	4.91	13,497,213	2,418,805
1991	288,542	4.15 (4)	11,981,299	288,542	5.08	14,668,097	2,686,798
1992	302,969	4.28 (4)	12,957,775	302,969	5.26	15,940,554	2,982,779
Revised Projections (5)							
1988	308,599	3.80 (4)	\$11,726,770	308,599	4.59	\$14,164,703	\$2,437,934
1989	321,062	3.91 (4)	12,566,361	321,062	4.75	15,252,525	2,686,164
1990	334,148	4.03 (4)	13,470,895	334,148	4.92	16,429,782	2,958,887
1991	347,888	4.15 (4)	14,445,560	347,888	5.09	17,704,059	3,258,499
1992	362,315	4.28 (4)	15,495,964	362,315	5.27	19,083,595	3,587,631

(1) Negotiated fixed rate.

(2) Negotiated rate-first-year rate of 3.2 cents per Kwh with 2.5% annual adjustment after first year.

(3) Assumes annual 5% growth in accordance with normal business planned growth.

(4) Under negotiation-first-year rate of 3.8 cents per Kwh with 3% annual adjustment after first year.

(5) Assumes annual 5% growth in accordance with normal business planned growth plus 2596 additional power needs for Defense Contract.

EXHIBIT VII-A

EMPIRE GLOBE - FELDPOR PLANT
BALANCE SHEETS (in thousands of dollars)

	REVISED FORECAST WITH DOD 1988	REVISED ORIGINAL CONTRACT 1988	FORECAST 1987	ESTIMATE 1986	ACTUAL			
					1985	1984	1983	1982
SALES REVENUES	<u>\$91,125</u>	<u>\$72,900</u>	<u>\$67,500</u>	<u>\$62,328</u>	<u>\$57,646</u>	<u>\$53,008</u>	<u>\$49,279</u>	<u>\$42,798</u>
COSTS:								
MATERIALS & SUPPLIES	\$31,894	\$25,880	\$24,300	\$22,999	\$21,387	\$19,719	\$18,430	\$16,007
POWER	11,727	9,470	8,400	7,791	7,297	6,763	6,334	4,652
CONTRACT LABOR	6,930	6,300	5,500	5,111	4,669	4,241	3,992	3,509
TRUCKING	4,980	4,330	4,200	3,927	3,689	3,446	3,252	2,867
SALES SERVICE	1,307	1,281	1,220	1,122	1,095	1,007	1,035	856
REPAIR AND MAINTENANCE	2,964	2,646	2,450	2,244	2,075	1,908	1,774	1,541
RESEARCH & DEVELOPMENT	925	925	1,200	1,500	1,525	1,475	1,440	895
GENERAL ADMINISTRATION	1,075	1,025	920	800	780	820	775	770
INTEREST EXPENSE	3,450	2,750	2,350	1,780	1,450	1,280	1,260	1,160
OTHER	<u>895</u>	<u>830</u>	<u>755</u>	<u>645</u>	<u>725</u>	<u>660</u>	<u>710</u>	<u>680</u>
	66,145	55,437	51,295	47,918	44,693	41,319	39,002	32,937
ADD: DEPRECIATION	<u>15,800</u>	<u>15,600</u>	<u>15,500</u>	<u>14,000</u>	<u>12,500</u>	<u>11,250</u>	<u>9,875</u>	<u>9,450</u>
TOTAL COSTS	<u>81,945</u>	<u>71,037</u>	<u>66,795</u>	<u>61,918</u>	<u>57,193</u>	<u>52,569</u>	<u>48,877</u>	<u>42,387</u>
INCOME BEFORE INCOME								
TAXES	<u>\$9,180</u>	<u>\$1,864</u>	<u>\$705</u>	<u>\$410</u>	<u>\$453</u>	<u>\$440</u>	<u>\$402</u>	<u>\$411</u>

EXHIBIT VIII-A

EMPIRE GLOBE - FELDPOR PLANT
BALANCE SHEETS (in thousands of dollars)

	REVISED FORECAST WITH DOD CONTRACT	REVISED ORIGINAL FORECAST	ESTIMATE	ACTUAL				
	<u>1988</u>	<u>1988</u>	<u>1987</u>	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
ASSETS								
CURRENT ASSETS	<u>\$27,565</u>	<u>\$22,107</u>	<u>\$20,520</u>	<u>\$19,032</u>	<u>\$17,620</u>	<u>\$16,210</u>	<u>\$15,084</u>	<u>\$13,101</u>
PROPERTY, PLANT, EQUIPMENT	147,200	145,800	144,800	131,300	116,700	104,400	91,325	87,500
LESS: DEPRECIATION	<u>106,425</u>	<u>106,225</u>	<u>90,625</u>	<u>75,125</u>	<u>61,125</u>	<u>48,625</u>	<u>37,375</u>	<u>27,500</u>
NET	<u>40,775</u>	<u>39,575</u>	<u>54,175</u>	<u>56,175</u>	<u>55,575</u>	<u>55,775</u>	<u>53,950</u>	<u>60,000</u>
TOTAL ASSETS	<u>\$68,340</u>	<u>\$61,682</u>	<u>\$74,695</u>	<u>\$75,207</u>	<u>\$73,195</u>	<u>\$71,985</u>	<u>\$69,034</u>	<u>\$73,101</u>
LIABILITIES								
CURRENT LIABILITIES	\$11,024	\$9,726	\$8,844	\$8,557	\$7,627	\$7,313	\$6,394	\$5,583
HEADQUARTERS EQUITY ACCOUNT	<u>57,316</u>	<u>51,956</u>	<u>65,851</u>	<u>66,650</u>	<u>65,568</u>	<u>64,672</u>	<u>62,640</u>	<u>67,518</u>
TOTAL LIABILITIES	<u>\$68,340</u>	<u>\$61,682</u>	<u>\$74,695</u>	<u>\$75,207</u>	<u>\$73,195</u>	<u>\$71,985</u>	<u>\$69,034</u>	<u>\$73,101</u>

EXHIBIT IX-A

EMPIRE GLOBE - FELDPORT PLANT
FUND FLOW STATEMENTS (in thousands of dollars)

	REVISED FORECAST WITH DOD CONTRACT	REVISED ORIGINAL FORECAST	ESTIMATE	ACTUAL				
	<u>1988</u>	<u>1988</u>	<u>1987</u>	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
SOURCES OF FUNDS								
NET INCOME	\$9,180	\$1,864	\$705	\$410	\$453	\$440	\$402	\$411
ADD BACK:								
DEPRECIATION	15,800	15,600	15,500	14,000	12,500	11,250	9,875	9,450
PROVIDED FROM OPERATIONS	\$24,980	\$17,464	\$16,205	\$14,410	\$12,953	\$11,690	\$10,277	\$9,861
CHANGES IN HEADQUARTERS EQUITY	-	-	-	672	443	1591	-	-
TOTAL SOURCES OF FUNDS	\$24,980	\$17,464	\$16,205	\$15,082	\$13,396	\$13,281	\$10,277	\$9,861
CAPITAL ADDITIONS	\$2,400	\$1,000	\$13,500	\$14,600	\$12,300	\$13,075	\$3,825	\$3,350
INCREASE IN WORKING CAPITAL	4,865	705	1,201	482	1,096	206	1,172	980
CHANGES IN HEADQUARTERS EQUITY	17,715	15,759	1,504	-	-	-	5,280	5,531
TOTAL USE OF FUNDS	\$24,980	\$17,464	\$16,205	\$15,082	\$13,396	\$13,281	\$10,277	\$9,861

EMPIRE GLOBE CORPORATION

SITUATION III

Struggling to keep an open mind, Susan Bond decided to first raise her concerns with the head of Empire's Feldport negotiating team, Jim Doran. After all, he had been involved with drafting the negotiation plan book in the first place. When she finally got through to him, Jim Doran sounded less than pleased to hear from Susan:

JIM: Susan. Hi. What can I do for you?

SUSAN: I need to talk to you about our new position on the utility rate. I'm having trouble.

JIM: Look, Sue, this isn't a good time. I'm about to leave for the airport.

SUSAN: Oh, I see. Well, can you call me when you get to wherever you're going?

JIM: I'll try. But I'm going to be awfully busy. And frankly, I don't know what to tell you about the rate thing, except that's what we need. Period.

SUSAN: Yes, but how did you...

JIM: I'm sorry, Sue, the limo is here. Why don't you try to reach one of the other team members? I've got to go. SUSAN: Sure, bye.

Susan fumed. She hated being put off. But that was part of Doran's style. Susan now knew she would have to go to the top. None of the other negotiation team members were in a position to do anything about the rate, anyway. Besides, from what Ted had said, they probably weren't even aware of the situation. Susan wasn't looking forward to talking to Treadstone. She knew how headstrong he was on this Feldport issue.

Finally she picked up the phone.

SUSAN: Hello, John. This is Susan.

JOHN: Ah good. How did it go with the Power Authority?

SUSAN: It didn't.

JOHN: What do you mean, "It didn't?"

SUSAN: I mean there wasn't any meeting. I canceled it.

JOHN: You canceled? Whatever for?

SUSAN: I didn't feel comfortable with our new rate request. I thought we were pushing it a little with 4.25.... But 3.8 isn't fair at all. I've run some projections at both rates, and I just don't see where we're coming from. I was hoping you could explain it to me.

JOHN: There's nothing to explain. We need that lower rate to keep the plant operating at a reasonable return. You're an economist; you can understand that, can't you?

SUSAN: I guess it depends upon how you define “reasonable.”

JOHN: And you think this is being unreasonable, or something?

SUSAN: Yes, I do. Especially when that defense contract kicks in and our profits go through the roof!

JOHN: So you know about that. Well, Susan, we have obligations to our stockholders, remember? And besides, we’re in business--what’s wrong with profits?

SUSAN: Nothing. But with the defense contract, returns would increase sharply anyway. Are these concessions really necessary? What about our “partnership,” as you choose to phrase it, with Feldport? Don’t forget John, government contracts become public record.

JOHN: Look, Susan. We needed lower energy costs to justify our bid on that defense contract. Besides, do you realize what the production increases mean to our “partners”? We’re talking about adding a third full shift, for starters. Do you think our “partners” are going to mind that?

SUSAN: But you lied about pulling operations out of Feldport if they didn’t acquiesce.

JOHN: Well, you’re entitled to your opinions. But you can’t let it keep you from doing your job. Have you rescheduled with the Power Authority?

SUSAN: Uh...no. I wanted to talk with you first.

JOHN: I see. And now that we’ve talked?

SUSAN: Okay ...I get the message. But what if they don’t agree to the lower rate?

JOHN: Susan, negotiating means getting agreements. Anything else on your mind?

SUSAN: No.

JOHN: Fine. I’m counting on you, Susan ...Let me know how it turns out.

SUSAN: I will.

When Susan Bond got off the phone with Treadstone, she knew she was facing the most significant decision of her career. She didn’t like what was happening at Empire Globe, but she wasn’t sure what to do about it. Not yet, anyway.

Susan began to review her options. Several appeared realistic to her—realism being defined in her mind as revealing the truth without becoming a sacrificial lamb. Recalling her father’s business maxim “Slaughtered animals are meant to be eaten,” Susan determined she would not be devoured.