World Resources Institute

Sustainable Enterprise Program
A program of the World Resources Institute

MULTIPAINT, INC.

For more than a decade, WRI's Sustainable Enterprise Program (SEP) has harnessed the power of business to create profitable solutions to environment and development challenges. BELL, a project of SEP, is focused on working with managers and academics to make companies more competitive by approaching social and environmental challenges as unmet market needs that provide business growth opportunities through entrepreneurship, innovation, and organizational change.

Permission to reprint this case is available at the BELL case store. Additional information on the Case Series, BELL, and WRI is available at: www.BELLinnovation.org.

INTRODUCTION

MultiPaint, Inc. (MPI) is a comprehensive case about a fictitious company producing "environmentally friendly" paints and stains. When news is leaked to the press about a serious contamination problem at an idle manufacturing site, a team of consultants is called in to evaluate several alternatives. In addition to encompassing financial and managerial accounting aspects, the case also incorporates non-accounting issues as well ─ including legal, ethical, and public relations concerns. On the surface, the case seems to simply require a (reasonably rigorous) net present value analysis. However, when non-quantitative dimensions are considered, the appropriate course of action becomes less clear.

This case was prepared by Robert M. Bowen, Stephan E. Sefcik, and Naomi S. Soderstrom, University of Washington, Seattle, Washington, U.S.A., as the basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation. This case is designed to facilitate classroom discussion. It has benefited from the helpful comments of Jane Israel, Jim Jiambalvo, Susan Moyer, Eric Noreen, Bill Resler, D. Shores, and participants in the First Annual Undergraduate Accounting Case Competition at the University of Washington. Holger Soderstrom prepared the artwork. Distributed by the Accounting Education Resource Centre, The University of Lethbridge, © 1996. All rights reserved to the authors and to the Accounting Education Resource Centre. Reprinted from The Journal of Accounting Case Research with the permission of Captus Press Inc., North York, Ontario, Canada and the Accounting Education Resource Centre of the University of Lethbridge, Lethbridge, Alberta, Canada. **[Journal Subscription, Captus Press Inc., York University Campus, 4700 Keele Street, North York, Ontario, M3J 1P3, by calling (416) 736-5537, or by fax at (416) 736-5793, Email: info@captus.com, Internet: http//www.captus.com]**

Balmer Consulting Group
Interdepartmental Memo

To: BLUE team leader
From: Dennis Wayne, Partner
Re: MultiPaint, Inc. – your new assignment

Date: May 18, 1994

I appreciate your willingness to take over the MPI engagement at this late date. As you may have heard, I initially assigned Lois Baron's "Green" team to this engagement. However, a potentially lucrative project has surfaced in South America. Because of Green team's experience and Spanish-language skills, I have decided to reassign Lois and her team to the new project.

Attached are Green team's confidential notes compiled from several meetings with MPI management. Your task is to respond to management's concerns outlined in their letter dated May 13, 1994. The due date for presenting your oral recommendations to management is Friday, May 20, 1994. This meeting with management precedes their emergency Board of Directors meeting scheduled for Monday, May 23, 1994.

This is a challenging assignment and I know you'll be excellent representatives of the Balmer Consulting Group. I have the greatest confidence in you and your team.

cc: Lois Baron, Green team leader

MultiPaint, Inc.
Engagement Notes

[*CONFIDENTIAL*]

Balmer Consulting Group
Prepared by the Green Team
Lois Baron, team leader
Preliminary and Incomplete
May 18, 1994

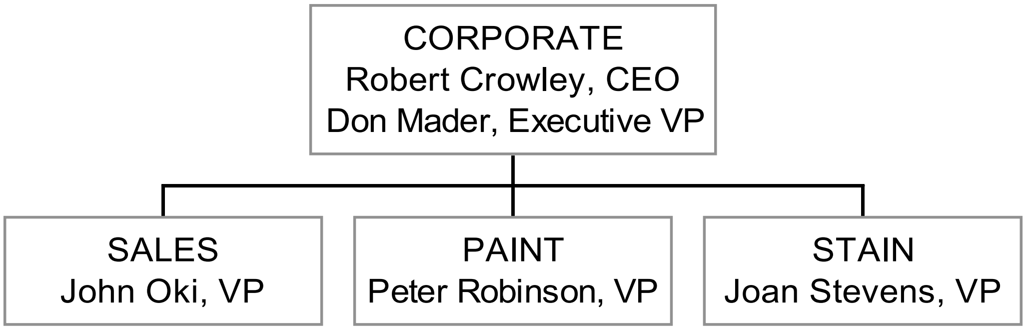
Balmer Consulting Group
MultiPaint, Inc.

Notes prepared by the Green Team
Lois Baron, Team Leader

Company Background

MultiPaint, Inc. (MPI) manufactures and markets its products throughout the United States and Canada. The company has been in existence for over 40 years, and has been publicly traded for the last fifteen years. Despite intense competition from national and private-label brands, annual sales have grown each year for the last 10 years and exceeded $150 million for the first time for the fiscal year ended February 28, 1994. MPI has become one of the larger firms in the industry with total assets of $265 million and total liabilities of $108 million. The Company's organization is centralized, with three divisions reporting to "Corporate" headquarters – Sales, and two manufacturing divisions, "Paint" and "Stain," as depicted below.

Paint Division, headed by Peter Robinson, is the older of the two manufacturing divisions and until recently, was located near downtown on a six-acre commercial site at the edge of the warehouse district. This site was originally chosen because its prime waterfront location facilitated shipping to four West Coast distribution centers (located in San Diego, San Francisco, Portland, and Vancouver, B.C.) Paint Division relocated to the eastside suburbs in November 1993. Reasons for the move included: a need for modernization and expanded capacity, a reduction in the cost of commuting for employees, and an opportunity to sell the old waterfront site at a substantial profit. The new production facilities have convenient access to Interstate 90.



Stain Division, headed by Joan Stevens, and Sales, headed by John Oki, are currently located on the corporate "campus" approximately 14 miles south of the new paint manufacturing facility in an area of warehouses and light industrial buildings. Corporate headquarters is also located on the South Campus and is housed in a separate facility that was renovated in 1992. The company's long-term plan is to move Stain Division to the new eastside site. Sales and Corporate would remain at the South Campus.

Management Changes Lead to New Marketing Campaign

Robert Crowley was hired in January 1993 to take over as CEO of MPI. (Note that this and other important MPI events are summarized in Exhibit 1.) He replaced a well-liked manager who had been with the Company over 40 years, the last 12 as CEO. Crowley's former position was Vice President of Marketing at a major competitor.

Crowley was concerned that, although MPI sales had risen steadily over the past decade, profit margins had eroded, causing earnings to flatten. After consulting with management, suppliers, and major customers, Crowley decided that his first initiative would be to launch a new marketing campaign. The campaign introduced a new corporate theme, "Painting America Safe and Clean," that addresses increasing environmental concerns among consumers. Excerpts from Crowley's memo to the management team summarize factors that contributed to this strategy:

- "The paint market has become increasingly price competitive and product differentiation is one way to earn superior profits. If our new campaign is successful, it will preempt competition nationally. The first company to market environmentally-friendly products tends to maintain the advantage."

- "Environmental safety is a major concern among our customers, especially here in the Pacific Northwest."

- "Environmentally-conscious products are being successfully introduced in other markets (e.g., Safer® pesticides)."

- "Federal regulations have caused the Company to eliminate many of the toxins that were formerly used in paints (e.g., lead, mildewcides). Thus, a claim that MPI's paints are environmentally-friendly can be easily backed up without having to immediately invest in new products. Further, our new paint manufacturing plant, which is scheduled to go on line late in calendar 1993, will be more efficient and produce fewer waste by-products."

- "We have an opportunity to add to the Board of Directors several individuals who have earned reputations as advocates for the environment. We expect these appointments to lend added credibility to our new environmental theme."

Early indications are that the marketing campaign has been and will be successful. New Board members were added in April 1993. (See the agenda for the April 1993 Board meeting.) As a result of the environmental interests of Crowley and the new Board members, upper management began attending workshops in areas such as Total Quality Environmental Management (TQEM) and Environmental Management Systems (EMS).

The Environmental Audit

After one particularly stimulating workshop, the Executive Vice President of Operations, Don Mader, convinced the Director of Internal Audit, Alice Ray, to include some Environmental Audits in her schedule starting June 1993. (See Exhibit 2 for a complete organization chart.) Don argued that Environmental Audits are a proactive tool to identify and manage potential environmental problems. In addition, managers of firms with strong Environmental Audit programs are likely to face a reduced threat of criminal penalties should an environmental problem come to the attention of the Department of Justice. The Director of Internal Audit met with division managers and targeted specific areas to audit.

In September, during the course of one of these audits, the Stain Division was found to be out of compliance with Resource Conservation and Recovery Act (RCRA) requirements for tracking of acetone and toluene, two byproducts of the production process for many stains.[1] Upon conclusion of the audit, the internal auditor met with Joan Stevens to develop a design proposal to correct the problems with the system. The audit and the system design proposal (with an attached supplemental budget request for $30,000) were presented to Corporate. Unfortunately, the systems development budget for 1993 was already over-committed, so the project was postponed until 1994-95. A disgruntled worker in Stain Division became upset when no progress was made on the system and reported the violation to the local Environmental Protection Agency (EPA) office. A subsequent

1 Under RCRA, companies that generate large quantities of hazardous waste are required to implement a manifesting system to track the waste from "cradle to grave."

government inspection identified several shipments of acetone and toluene for which there were no shipping manifests or inventory records. The resulting fine of $100,000 was allocated directly to Stain Division.

Following this action, Stain Division's manager, Stevens, became less enthusiastic about the audit program and expressed to one senior manager her reluctance to be as cooperative in any future audits. Stevens was particularly upset over the allocation of the fine, since the Stain Division's tracking and accounting systems were designed by Corporate. Stevens wrote a memo to Corporate stating: "I am a member of the Sierra Club. Obviously, I am concerned about the environment! As head of the Stain Division, I have always tried to follow all regulations, especially those pertaining to the environment. Recall that we volunteered to be the first division to participate in your 'Environmental Audit' program. In light of our initiative, and since the tracking system had not been updated as requested, I do not feel that my division should be penalized."

Preliminary Observations about MPI's Divisional Structure

Managers of the Paint, Stain, and Sales divisions appear to be quite competitive with each other. The two manufacturing divisions are evaluated based upon actual division costs versus a flexible budget. The sales division is evaluated based upon actual gross revenues relative to a pre-determined target. Each year, the bonus pool is split among division managers according to their relative performance. In some years, the bonus has been split approximately evenly, but in other years, one division has received almost the entire pool.

The fine discussed above will undoubtedly affect the bonus pool allocation at the end of the year (unless the Compensation Committee of the Board intercedes). We feel these problems are due to the corporate structure and compensation schemes at MPI. Once the "environmental fires" are put out, there may be opportunities to assist the Company in a major reorganization.

Disposal of the Old Paint Plant Site

By January 1994, essentially all paint production had been moved to the new plant. Crowley felt it was a good time to sell the waterfront property. Because of its prime location, the land was sought after for multiple uses, including construction of a retail/entertainment complex with luxury condominiums on upper levels. By early April 1994, a large local developer entered into a preliminary agreement to purchase the property for $22 million (net of transfer tax and closing costs), subject to the availability of construction financing and the usual inspections. Based on this tentative purchase agreement, the bank ordered a site assessment before it would grant credit.

Unfortunately for MPI, the inspection revealed a major environmental problem. Evidently, in the past, the Paint Division had disposed of certain toxic byproducts by encasing them in 55-gallon steel drums and burying them on site. At that time, it was standard industry practice and not illegal. (In fact, additional acreage had been purchased in the 1950s for that very purpose.) In the course of the inspection, an environmental engineer discovered toxic chemicals in both the groundwater and run-off from the property into Puget Sound. The engineer concluded that at least some of the drums had developed leaks over time. Standard procedure for remediation of this type of environmental contamination entails excavating the drums and disposing of them in a certified toxic waste disposal facility, refining the top 10 feet of soil over the entire site, restoring water quality through installation of a filtration system, and monitoring the site for future contamination. The plant itself would likely have to be razed as contamination probably extends under the buildings. The bank requires that the area be cleaned up before it will lend any money on the property.

Preliminary Options

After a number of discussions with management, preliminary options for dealing with the old paint site are listed below. Every option will require substantial outside legal assistance. As Don Mader noted: "At this point, we'll need to budget $1 million up front under any of these alternatives." Note that additional facts not incorporated in the discussion of the individual options are included in Exhibits 3 and 4.

1) MPI cleans up the property; sell land in three years

Crowley stated, "We have a lot to learn about environmental regulations and cleanup, but hopefully, …without any major glitches, we should be able to handle the problem ourselves." This option would require purchasing specialized cleaning equipment for $2,375,000. This equipment has an estimated salvage value of $175,000 at the end of three years. Maintenance of equipment should average $120,000 per year. Incremental working capital required for the duration of the project should be $325,000. A manager specializing in hazardous site remediation would be needed at $80,000 per year to oversee the operation. In addition, other environmental specialists would have to be hired. However, MPI could use all of the factory workers that were scheduled to be laid off in the next year for much of the manual labor. Thus, non-management direct labor costs would be $1,625,000 per year (including $950,000 for MPI workers previously scheduled to be laid off). Because all existing structures on the site would be razed in the course of remediation, a nearby warehouse would be leased at an estimated cost of $50,000 per year. Susan Whitten, MPI Controller, estimated that $1,218,750 of Corporate overhead would be allocated to the project "…based on our standard burden rate of 75% of direct labor dollars." However, she noted that incremental overhead costs associated directly with this project should run approximately $750,000 per year. Management believes that the sales price of the land would be similar to the recently negotiated deal, although the property would not be available for sale for approximately three years.

2) Contract with outside party for cleanup; sell land at end of two years

Management has received three "preliminary" estimates from environmental contractors for site cleanup. Crowley noted, "An advantage of being in the Northwest is that we have a number of large and experienced contractors to choose from." The bids range from $19 to $24 million. Each would be paid in three equal installments starting with a down payment due at contract signing and the final payment due on completion at the end of year two. All three companies claim they can complete the job in two years. In addition, all three companies are willing to indemnify MPI against further cleanup costs for an amount up to their respective bids.

3) Sell the land to the same developer, "as is," at a discount

"Another alternative that we haven't considered is to sell the land as is. I had lunch with the Developer and he expressed willingness to 'take it off our hands at the right price.' I bet we could get them to pay $1.5 million."

Management believes that the Developer is capable of conducting the cleanup. In fact, due to a recession in the construction market, they feel that he could use otherwise idle equipment and employees. Robinson commented, "My recollection is that the Developer has done reclamation projects before."

4) Donate the land

One senior MPI executive suggested that "...the easiest way out of this mess would be to sell the property to the City for $1 to be used as a waterfront park with the City assuming all liability for cleanup and indemnifying the company against any future legal action." Crowley interjected, "I like it. The City has been desperate to increase park space in the downtown area and we've got waterfront we can give them. We could even ask for a prominent plaque acknowledging MPI's contribution." Susan Whitten noted, "There is also potential for substantial tax savings associated with our 'charitable' contribution." While most of the management team felt this could be a public relations coup, others thought this strategy was risky because it "…exposes the Company to greater scrutiny in the press. The gifting process could drag out if members of the City Council decide to take the opportunity to posture on environmental issues and the 'questionable motives' of MPI management."

5) Re-open old site for manufacturing

The government of a late-developing country had recently approached MPI with a firm three-year contract to produce a large quantity of lead-based paint to be used to repaint the outer hulls of its naval fleet. (Environmental regulations and potential legal liability make it expensive to sell these paints in the United States.) While Paint Division's new manufacturing facility was not designed to produce this type of paint, MPI could re-open its old downtown site and retool the factory for increased production of marine paint.

To operate the old facility on the waterfront site, MPI would first have to contain leakage from the buried drums. An outside environmental engineer claims to be confident that a barrier can be installed around the perimeter of the section of the site containing the drums. While this action would not remediate the toxic waste problem on site, the leakage should be contained on MPI's property.[2] The approximate cost of the containment system, including permits and installation, is $7,500,000. The engineer estimates the useful life of the barrier to be 20 years. Retooling of the old factory would also require an immediate cash outlay of $2,770,000 for facility restoration and specialized equipment purchase. The facility, including new equipment and upgrades, has a revised estimated life of 20 years and negligible salvage value.

The contract calls for delivery of 1 million gallons of paint in each of the first two years, and 1.2 million gallons in the final year. John Oki, head of the Sales division, expressed optimism. "This kind of paint is used on ships all over the world. It should be no problem to obtain similar contracts once this one runs out."

Incremental working capital required as long as the plant is kept open should be $675,000. The Corporate controller provides an estimate of the profitability of operating the renovated downtown plant in Exhibit 4. After seeing the controller's analysis, one senior manager commented: "In our haste to address these problems, I'm not sure we've identified all of the relevant costs and benefits. For example, if the alternative of keeping the old plant open is so attractive, why hadn't we considered it prior to the discovery of these environmental problems!?"

---

2 Current Federal and State Laws do not require a site to be immediately cleaned up upon detection of contamination. Rather, a company is allowed to continue to operate its business as long as the damage is contained on the property and a cleanup plan is submitted. As long as the company continues to operate on the site, the cleanup (but not the containment, if necessary) is postponed.

Exhibit 1 – Chronology of Events

Date	Event	Related exhibit
January 1993	Robert Crowley hired as new CEO	
April 25, 1993	New Board members; new environmental policies	Board agenda (1)
May 1, 1993	Introduced new marketing campaign	
April & May 1993	Management attended TQEM workshops	
June 1, 1993	Environmental audit established	
September 1993	Audit revealed record-keeping error; led to fine	
November 1993	Paint manufacturing relocated to suburban site	
February 28, 1994	Fiscal year end	
April 3, 1994	Negotiated to sell downtown site; buyer identified	
April 29, 1994	Inspection of downtown site revealed contamination	
May 4, 1994	Insurance did not cover environmental damage	Letter fr: Insurance Co. (2)
May 6, 1994	News leaked to press	Seattle Post article (3)
May 8, 1994	Editorial cartoon attacked MPI	Seattle Post cartoon (4)
May 11, 1994	Auditor warns of possible qualification	Letter from auditor (5)
May 12, 1994	Bank warns that line of credit may be reduced, etc.	Letter from bank (6)
May 13, 1994	MPI hires BCG	Engagement letter (7)
May 16, 1994	Announce agenda for emergency board meeting	Letter with agenda (8)
May 17, etc.	Internal strife	Memos (9)
May 17, 1994	Sales slippage caused by negative press?	Memos fr: sales mgr. (10)
May 20, 1994	BCG meeting with Management	
May 23, 1994	Emergency board meeting	
May 31, 1994	External audit report due for FYE Feb. 28, 1994	

EXHIBIT 1 continued - (1)

Meeting Agenda
Board of Directors
April 25, 1993

I. Welcome and acceptance of minutes of prior meeting.

II. Finalize Interior Layout for new Paint Division building.

III. Internal Audit summary of Sales Commission Accounting audit.

IV. Consideration of new corporate environmental policies.

   a. Unveil new marketing campaign "Painting America Safe and Clean" on May 1, 1993.

   b. Change paint and stain labelling to include forest scenes.

   c. Contribute to organizations that are concerned about the environment, such as the Sierra Club, the Environmental Defense Fund and Greenpeace. Consider linking profits to contributions.

   d. Sponsor Earth Day activities at the University of Washington.

   e. Posting signs throughout the organization, "Protect the Earth--She's the Only One We've Got."

   f. Increase the amount of environmental disclosure in financial statements.

V. Wrap up of fiscal year.

WASHINGTON FIDELITY
1000 Hartford Way
New York, NY 01001

May 4, 1994

Don Mader, Executive Vice President
MPI Paint, Inc.
Renton, WA 98155

Dear Mr. Mader:

We regret to inform you that policy number 91-145801 does not cover the chemical leakage at your downtown site. If you will please refer to your copy of the policy, Section 28, paragraph 24-7A(iii), you will see clearly that it expressly precludes coverage of environmental damage that results directly or indirectly from the Company's manufacturing activities.

We hope this clarifies the situation. We look forward to your future business.

Sincerely,

Martin Lang
Account Manager

Multi Paint, Inc. Linked to Pollution in Puget Sound

EXHIBIT 1 continued - (3)

Post Staff Reporter

An undisclosed source at MPI revealed that a toxic chemical used in MPI's paint manufacturing process has been discovered in the groundwater and run-off from the site of its now idle downtown facility. Three recreational beaches near the plant had been closed earlier this year. The unnamed source suggested that these closures are related to problems at MPI. The cause of the pollution had not been previously identified.

A spokesperson for MPI assured the *Post* that disposal of any hazardous chemicals has always been according to law. MPI's spokesperson went on to say that allegations of this type are frequently made against companies in this industry and are usually unfounded. He indicated, however, that the allegations would be fully investigated.

An official from Washington's Department of Ecology would not comment on the specific allegations but indicated MPI was on its Site Investigation List.

MPI has recently been in the news for the success of its new marketing campaign that emphasizes its environmentally-friendly products. The Company is also a sponsor of Earth Day activities at the University of Washington.

Seattle Post, 5/6/94, p. A2

EXHIBIT 1 continued - (4)

④

Seattle Post Cartoon

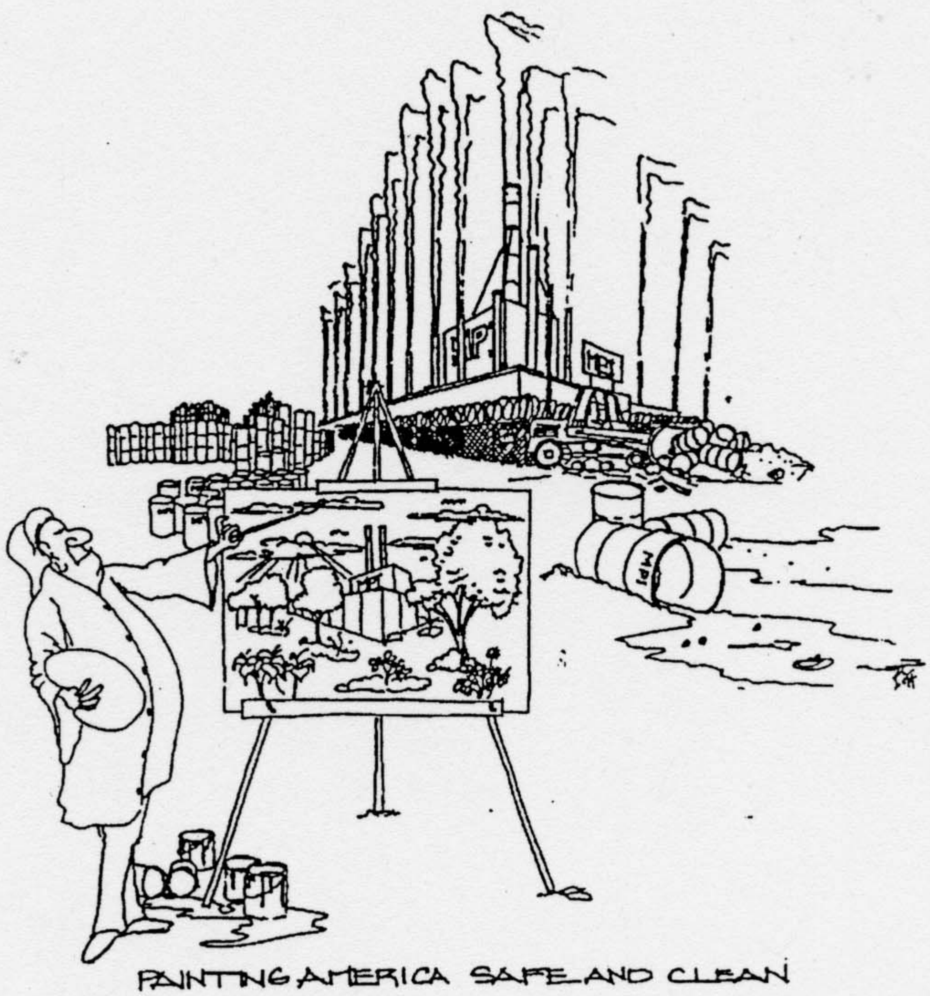


EXHIBIT 1 continued - (5)

HASKINS, WHINNEY, & ROSS
Certified Public Accountants
777 Fifth Ave
Suite 1000
Seattle, WA 98101

May 11, 1994

Robert Crowley, CEO
MPI Paint, Inc.
Renton, WA 98155

Dear Robert:

As we discussed yesterday on the phone, we are concerned about the recent article in the *Seattle Post* (5/6/94). Because the alleged leakage is indicative of a problem that was present during the fiscal year ended February 28, 1994, we have a responsibility to review the situation to determine whether anything has occurred that might affect the valuation or disclosure of the financial statements under review. In a worst-case scenario, we would have to qualify our opinion on your forthcoming financial statements. If you feel it would be helpful, we are willing to send over our in-house team of environmental specialists to take some soil and water samples.

It is important that we resolve this issue in an expeditious fashion in order that your 10-K can be filed with the SEC inside the 90-day period following fiscal year end.

We appreciate your help in resolving this matter.

Sincerely,

Angel Ross, Partner

St. Helens Bank of Washington

101987 Wall St.
Seattle, WA 98101

May 12, 1994

Robert Crowley, CEO
MPI Paint, Inc.
Renton, WA 98155

Dear Robert:

We at St. Helens are genuinely appreciative of your business over the last 40 years, and as your personal banker, I have enjoyed both our professional and personal relationship. We have just been informed of your recent "difficulties" at the Paint Division site. Please do not view this friendly advice as a "veiled threat." However, given the regulatory and legal climate in the banking industry, our Lending Review Board has become ultra-conservative. You should be aware that any negative environmental disclosure may result in a reduction of your line of credit. Further, if this unfortunate event should make its way into your financial statements, we may be forced to restructure your $15 million loan of January 1994 due to violation of a loan covenant restricting the ratio of debt to equity.

Best of luck dealing with this uncomfortable situation. I look forward to seeing you this Saturday at St. Helen's 14th Annual Client Appreciation Golf Tournament.

Sincerely,

Linda Crandall

MPI Multi Paint, Inc. Renton, WA 98155
Painting America Safe and Clean

May 13, 1994

Dennis Wayne, Partner
Balmer Consulting Group
230 Mackenzie Blvd.
Seattle, WA 98195

Dear Dennis:

The purpose of this letter is to engage your firm to help us resolve a significant environmental issue that has surfaced recently at our company. As you are aware, the *Seattle Post* article and editorial cartoon have exacerbated an already sensitive situation. Unfortunately, we are afraid that this negative press may be only the beginning unless we can control the damage quickly.

As previously discussed, we have a potential environmental problem at the former site of our Paint Division. Given we have emphasized our positive environmental image in our marketing campaign over the past year, we need to minimize the negative impact of this problem. Specifically, we want you to review our options for the property and thoroughly explore all implications of the alternatives, including any accounting, management, public relations, tax, ethical, or other issues that you deem relevant.

We also need your opinion on a financial reporting issue (before we respond to our outside auditor). Our accounting department was under the impression that the cost of cleanup could be capitalized (per EITF 90-8), but our auditors seem to focus on is whether or not we need to record a liability for the potential cost of cleanup (per SFAS 5). Please advise us on a strategy and inform us of any disclosures that may be required.

Your recommendations will be presented to our management team at a meeting scheduled for Friday, May 20, 1994. We cannot delay this meeting as we have an emergency Board meeting on Monday, May 23.

Finally, if these immediate problems can be handled expeditiously, we can discuss extending the engagement to examine alternatives to our current organizational structure.

Thank you for your willingness to pursue this severe problem on such short notice. Your compensation will be as previously negotiated.

Sincerely,
Robert S. Crowley, CEO

MPI Multi Paint, Inc.
Painting America Safe and Clean

Interdepartmental Memo

May 16, 1994

To: Peter Robinson, Paint Division
Joan Stevens, Stain Division
John Oki, Sales Division
James Williams, Corporate Legal Staff
Board of Directors

From: Robert Crowley, CEO

Re: Emergency Board Meeting

Below is the agenda for an emergency board meeting, scheduled for May 23, 1994 at 10:00 am. Please clear your calendars and plan to attend.

Meeting Agenda
Board of Directors
May 23, 1994

I. Welcome and acceptance of minutes from prior meeting.

II. Development of Strategy for former Paint Division site.

   A. Background - Manager, Paint Division

   B. Legal Exposure - Director, Corporate Legal Staff

   C. Recommendations - Balmer Consulting Group

      1. Alternatives for property

      2. Accounting and Disclosure Issues

      3. Recommendations and Media Relations

EXHIBIT 1 continued - (9)

MPI Multi Paint, Inc.
Painting America Safe and Clean

Interdepartmental Memo

May 17, 1994

To: Don Mader, EVP
From: John Oki, Sales Division

Re: Bad Publicity, Sales Drop-Off, and Effect on Morale

The recent unfavorable article and subsequent editorial cartoon in the *Post* and the unending barrage of rumors about MPI's environmental problems are having a large negative effect on the morale of my sales team. Sales have fallen off substantially in the last two weeks. Several customers have specifically mentioned our environmental reputation as the reason for their order cutbacks. My sales team is spending more time defending our environmental policies than promoting our products. How can the company that is "Painting America Safe and Clean" have the type of environmental problems that we are having? At a minimum, I need to assure my team that we have a plan to effectively respond to this negative publicity.

In addition, I would feel much more comfortable if I could tell the team that we are negotiating new sales quotas that take into account the company's current status. I would also like to talk with you privately at a later date about updating my sales target.

MPI Multi Paint, Inc.
Painting America Safe and Clean

Interdepartmental Memo

- - Confidential - -

May 17, 1994

To: Don Mader, EVP
From: James Williams, Legal Department

Re: Paint Division's Former Site

Please do not take any actions relative to the alleged leakage at Paint Division's former site without consulting with us. In particular, please do not make any announcements to the public, as disclosure can be used as evidence in potential lawsuits.

We appreciate being included in the May 23 meeting. However, it is imperative that we be given at least 30 minutes of the meeting time to review the legal issues at hand.

MPI Multi Paint, Inc.
Painting America Safe and Clean

Interdepartmental Memo

May 17, 1994

To: Don Mader, EVP
From: Bill Ruys, Tax Department

Re: Emergency Meeting Agenda

When reviewing the agenda for the upcoming "emergency" board meeting, we noticed that our department will not be formally represented during the discussion of the old Paint Division site. We believe it is essential that we participate in this discussion. Any use or disposal of the property could have large tax consequences that must be taken into account before a decision is made. Please advise.

MPI Multi Paint, Inc.
Painting America Safe and Clean

FILE COPY
Interdepartmental Memo

- - Confidential - -

May 17, 1994

To: Don Mader, EVP
From: Peter Robinson, Paint Division

Re: Allocation of Environmental Costs

I would like to comment on the accounting treatment of Stain Division's RCRA fine. I believe that, in this case, the fine was appropriately traced to the Stain Division. There is no excuse for sloppy record keeping and the responsible parties should be held liable. Let me assure you that there are no such tracking deficiencies in Paint Division.

I am concerned, however, that all future environmentally related costs might automatically receive identical treatment. I would urge you to carefully consider each case individually. If fault cannot be traced to current division management, I would argue that such environmental costs should be allocated to Corporate.

Exhibit 2

MPI
Organization Chart
May 1994

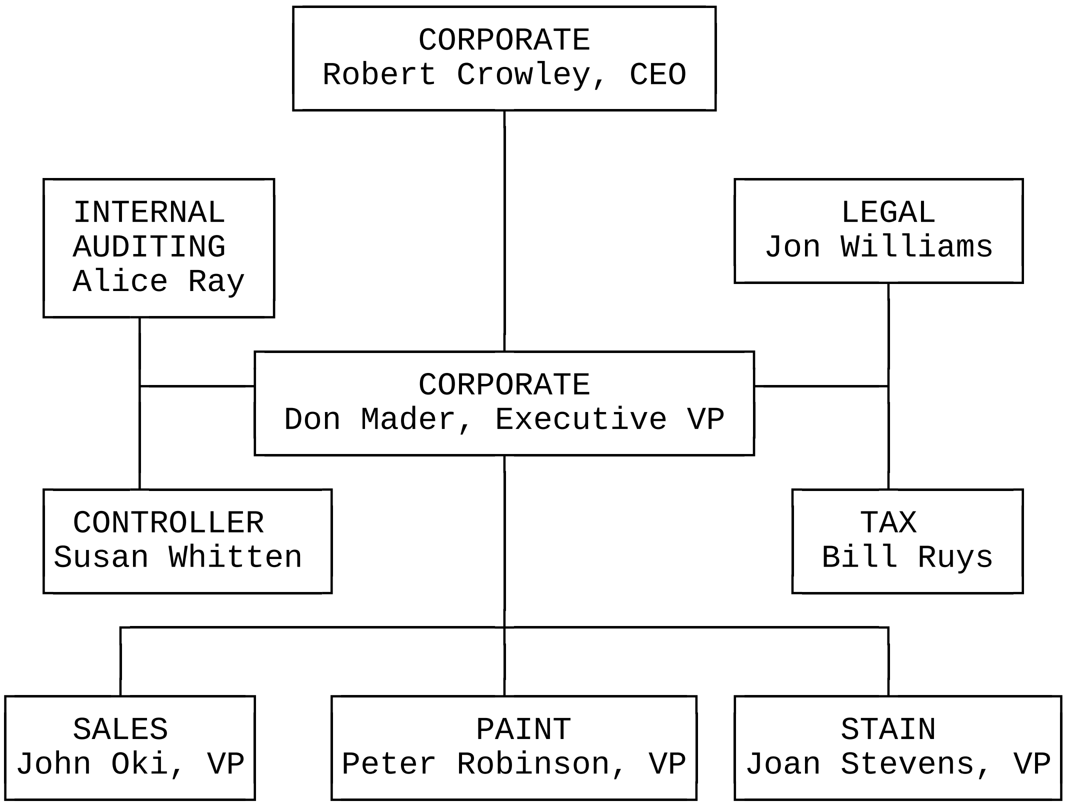


Exhibit 3

MPI
Additional Data related to Old Paint Manufacturing Site

- As of the fiscal year ended February 28, 1994, the book value of buildings and land at the old downtown site was $55,000, entirely attributable to the land (i.e., the buildings are fully depreciated).

- If the downtown paint manufacturing site remains closed, the old equipment will be hauled away at no net cost to the Company. The remaining book value of the equipment of $160,000 will be written off as a period expense.

- With the closure of the old less-efficient plant, the company found itself with 600 tons of excess inventories of lead-based paint pigments with an original cost of $900,000. The plan had been to sell these pigments at 50% of their original cost, or approximately $450,000. However, if the old plant continues to operate, these inventories can be used at the rate of one-half pound per gallon produced. New lead-based paint pigments, if necessary, are estimated to cost $1,800 per ton.

- The Company's nominal (after-tax) cost of capital is 12%. Since the (after-tax) effects of inflation have been averaging approximately 2% in recent years, management estimates that its real (after-tax) cost of capital is approximately 10%. However, Susan Whitten has asked us to discuss which rates are appropriate for each of the proposed options.

- To save bookkeeping costs, the Company uses the same accounting methods for book and tax purposes wherever possible. For example, MPI uses straight line depreciation for both financial and tax reporting.[3] The tax rate applicable to all revenues, expenses, gains and losses is estimated to be 40%.

[3] This is a simplification of the tax rules.

Exhibit 4

MPI
Analysis of the Renovated Plant Option for the First Year
prepared by Susan Whitten, Corporate Controller

	Amount	Notes:
Revenue – paint sales under contract	$10,000,000	$10 per gallon
Direct material – other than paint pigments	($800,000)	8% of sales
Direct material – paint pigments	($375,000)	250 tons @ $1,500 per ton
Direct labor	($950,000)	using labor subject to layoff
Plant overhead:		
New plant manager's salary	($70,000)	estimate
Division manager's salary	($42,000)	40% of Robinson's salary
Machine maintenance	($60,000)	estimate provided by vendor
Waste disposal costs	($250,000)	increases 20% annually
Depreciation of plant and equipment	($138,500)	assumes 20-year life
Depreciation of containment barrier	($375,000)	assumes 20-year life
Utilities and indirect labor	($550,000)	estimate from plant manager
Paint Division overhead	($237,500)	25% of Direct Labor
Selling Division overhead	($500,000)	5% of sales*
Allocation of general Corporate overhead	($712,500)	75% of Direct Labor
Total costs	($5,060,500)	
Total Profit (before tax)	$4,939,500	

Notes:
* Given the nature of the contract, actual selling costs should be negligible.