



RCI, Inc. (D)

The following is a simplified business situation in which RCI must negotiate with Southeastern Electric Company for sale of steam during the calendar year 1983. The information in Part II is strictly internal to RCI. As this case is intended as an exercise, please ignore the effects of taxes and the time value of money. *(Part I info known to both sides.)*

Part I

You are the managing partner of RCI Inc., a company set up with a maximum of \$15 million in venture capital from 5 partners, including yourself. Its sole purpose is to build and operate a resource recovery facility for Westborough County. The plant will receive all of Westborough's residential and commercial refuse, recover usable materials for resale, and burn the residue, both to reduce it in size for landfill purposes and to produce steam which may then be sold.

You are confident that the construction will take exactly one year, starting January 1, 1982 and will cost \$50 million. RCI will put in \$10 million for construction. Because the plant would be worthless if it failed to work, commercial lenders had been unwilling to give RCI a loan. At Westborough's urging, the state had agreed to issue pollution bonds to provide RCI the necessary \$40 million (interest free) it needed. RCI negotiated away a profit on the construction phase of the enterprise in return for exclusive title to the by-products of the plant, the recovered materials and steam.

When operational (January 1, 1983) the plant will produce steam with an annual usable energy equivalent of 100,000 barrels of oil. You have identified two possible customers for the steam. The Acme Company has agreed to purchase all of your steam output during the six winter months, November to April inclusive, at 20% discount from the price of oil prevailing on January 1st of each year. They would be happy to commence this agreement on either January 1, 1983 or January 1, 1984.

The Southeastern Electric Company has expressed a willingness to discuss the purchase of all of RCI's output of steam during the year 1983.

This case is available for ordering from HBS Case Services (See, the order form included in Appendix 1).

5001 Sinclair Lane

Bmore

front side
GPM

On January 1, 1984, Southeastern will convert from oil to 100% nuclear energy and will then have no further use for the steam. If Southeastern agrees to purchase the steam, it will have to build a generating facility near the RCI plant to convert the steam into electricity. Construction of this facility would take one year and cost \$1 million. The facility's location and design is such that it is of no use to anyone but Southeastern, and will have no salvage value if not needed by them.

Part II

The principal risk in the construction of the plant is that it may prove to be technologically infeasible. Plants with similar, but not identical, technologies have been largely unsuccessful, but RCI was founded under the presumption that it had the engineers to correct the difficulties. While these engineers profess 100% confidence in their ability to make the plant work, you feel that a probability of 0.7 summarizes your belief that the plant will work. [Assume that the plant either works to specifications or does not and has zero salvage value.]

The sale of steam represents your principal source of revenue. You believe that the current oil price of \$35 per barrel will rise to anywhere between \$40 and \$80 by January 1, 1983, with all intermediate prices equally likely. Your plan is to negotiate a one-year contract with Southeastern for 1983 and then switch to supplying the Acme Company on a part-time basis thereafter on the terms outlined above. You currently see no other prospects for selling steam. The deal with Acme is sufficiently attractive to make the whole venture economically viable.

Each of the partners is quite wealthy. This investment is, for each, part of a large well-diversified portfolio. Thus the partnership should act risk-neutrally. Nonetheless, the partners made a firm commitment not to sink more than the initial \$15 million into the project.

Your skill as a negotiator will be judged on the "value added" by your negotiations with Southeastern, using the various probabilities and dollar figures given above.

⑨

4

30 x 100K

1983

\$40 x 100K

3M

5x
30 x 100K = 3M- 700K
2.1

- 700K