

BROWN & WILLIAMSON TOBACCO CORPORATION

INTERNAL CORRESPONDENCE

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DEC 2 1977

TO: MR. B. D. CUMMINS
VICE PRESIDENT FINANCE
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PRIVATE & CONFIDENTIAL

Mr. C. J. Heger

W. ...
File Schweitzer

FROM: MR. D. R. SCOTT/sr
SUBJECT: PJS CONTRACT

DATE: December 1, 1977

As you know, I met with Bill Mason, Dr. Sanford and Dave Strubel to review the proposed contract before they went to Chicago on November 17 to meet with Schweitzer. Since their meeting in Chicago I have talked with Dave Strubel regarding the results of the contract negotiation, reviewed his meeting report and also reviewed the latest draft of the contract.

Based on the analysis prepared by Al Diebold and other comments by the negotiating party I believe the initial conversion price negotiated with Schweitzer (i.e., 28¢ per pound) to be very reasonable from B&W's standpoint.

The contract provisions do not, however, allow B&W much protection in regard to price increases. Appendix B of the contract reads as follows:

The price (28¢ per pound in 1978) may be adjusted on an annual basis. Present price is deemed composed of 40% due to labor costs, 30% due to energy costs, and 30% due to other costs. It is agreed that future changes in these components of cost will be used as a basis for price change when documented as to their actual effect on the total cost. It is recognized that future adjustments in costs may alter the percent contribution of each type of cost in the above present cost formula.

Info on Prices to be provided to both Parties can be called to do anything not in contract

There are no provisions in the contract for settling disputes relating to the price increases. Dr. Sanford said he did not want to firm up the contract in this area as he thought disputes of this nature could better be resolved across the table.

Mr. Diebold's analysis indicated that inventory durations would be built up to six months duration (per Dave Strubel) in order to protect B&W against possible stockouts. This level of inventory probably could not be obtained in the initial contract period of three years as shown by the following illustration.

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	B&W Annual Requirements*	Maximum To Be Supplied Per Contract**	Difference for Inventory Buildup
1978	25 M pounds	30 M pounds	5 M pounds
1979	29 M pounds	30 M pounds	1 M pounds
1980	29 M pounds	30 M pounds	1 M pounds
	83 M pounds	90 M pounds	7 M pounds

(A) D&W Average Annual Usage

$$\frac{83 \text{ M pounds}}{3} = 27.6 \text{ M pounds}$$

(B) Usage Per Day

$$\frac{27.6 \text{ M pounds}}{240} = 115,000 \text{ pounds}$$

(C) Maximum Buildup

$$\frac{7 \text{ M pounds}}{115,000} = 61 \text{ days}$$

(D) Total Inventory at end of 1980

Present stock (PJS & PCL)	40 days
Buildup	61 days <i>or 120 days</i>
	101 days or 5 months

* This is per Dave Strubel and based on current expected manufacturing requirements for 1978, assuming the same for 1979 and 1980 and adding 4 M pounds in 1979 and 1980 for Lorillard production.

**The minimum is 20 M pounds in 1978 and 25 M pounds thereafter.

There are two offsetting factors, however. One is that management may not require six months duration of stock. The other is that Schwitzer could possibly supply more than 30 M pounds annually according to Mr. Strubel.

Mr. Diebold pointed out in his analysis that the terms of the contract allowed either party to terminate the contract with two years advance written notice. This has been changed to three years and should allow B&W more flexibility.

As far as I know, no determination has been made as to the date for closing the PCL plant or when the contract will take effect. Presumably, the contract will be dated January 1, 1978.

by mutual agreement
Clarity
always
month

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Overall, I believe the terms of the contract are reasonable except possibly for the lack of provisions in the contract for settling price disputes. Based on Mr. Diebold's analysis and assuming that price increases are in line with Mr. Diebold's estimate of 10% per year, considerable savings should be derived.

Please let me know if you desire any further review in regard to this matter.

A. Scott

D. R. S.

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