

## Chocolate Case <Issue 1>

### Summary of Blue's Argument

Red Corp. ("Red") had an obligation to deliver the Chocolate (the "Goods") by shipping the Goods by January 10, 2014. However, Red breached its obligation. Despite the fact that Blue Inc. ("Blue") allowed an additional period for performance to Red, Red did not perform its obligation within that period. Even if there were no breach on January 10, Red did not perform the obligation modified by both parties on January 11. Therefore, Blue is entitled to claim US\$1 million in damages caused by such non-performance.

#### **1. Red had an obligation to deliver the Goods by January 10, 2014.**

According to Art.1 and Art.3 of the Contract as shown in Exhibit 6 (the "Contract") between Red and Blue, Red had an obligation to ship the Goods by January 10, 2014 at the Port of Negotown. The trade term for the Contract is CFR (Incoterms®2010) and it stipulates, "*(The) seller must deliver the goods by placing them on board.*" Thus, Red's delivery is deemed to have been made when the Goods had been placed on a ship.

#### **2. Red breached its obligation.**

Red breached its obligation under the Contract by missing the ship that departed the Port of Negotown on January 10, 2014 for which Red had booked a space (¶31).

Red denies its non-performance by alleging that the final and binding legal precedent of Negoland (the "Precedent") says, "*if the seller and the buyer agree to settle a transaction by a letter of credit, the seller...may refuse to perform its obligation thereunder until a letter of credit is advised*". However, since the governing law of the Contract is UNIDROIT Principles 2010 ("UNIDROIT") and there was no agreement to comply with the laws and cases of Negoland, Red's argument should be rejected. Furthermore, as mentioned below, Red should be liable for its non-performance under UNIDROIT.

##### **(1) Red should be liable for the breach under Art.5.3.3 of UNIDROIT.**

Under UNIDROIT, Red's obligation only takes effect if the Letter of Credit (the "L/C") was advised to Red (Art.5.3.1 of UNIDROIT). That is, considering the function of the L/C securing the payment, the advice of the L/C should be the condition for Red to ship the Goods. In this respect, the Precedent is correct in general. However, in this case, Red may not rely on the non-fulfilment of the condition. The reason is as follows.

In this case, on December 19, Blue had informed Red that the L/C would arrive in two or three days, but the advice was not made even on January 9 (¶ 30, 31). In addition, Red was the only party that could be aware of the extraordinary situation. Moreover, Red was the party that chose Negoland Bank as the advising bank. In such a situation, under principle of good faith, it was Red's duty to check with Negoland Bank whether it

had been advised the L/C. However, Red violated its duty by neglecting to check with Negoland Bank (¶ 30, 31). Therefore, Red may not rely on the non-fulfilment of the condition.

**(2) Red should not be allowed to withhold its performance under Art.7.1.3 of UNIDROIT.**

Art.7.1.3 of UNIDROIT stipulates “*Where the parties are to perform simultaneously, either party may withhold performance until the other party tenders its performance*”. However, Blue’s obligation should be limited to make a request for an issuance of the L/C since both Arbitria Bank and Negoland Bank are third parties whose acts are beyond Blue’s control. Blue requested for an issuance of the L/C on December 19 (¶ 30). Thus, Red cannot withhold its performance.

Even if it were general understanding that a buyer’s obligation completes when the L/C is advised to a seller, at least in this case, Red should not be allowed to withhold its performance. This is because, under the circumstances that Red itself chose Negoland Bank as the advising bank, withholding its performance by relying on the situation caused by bank’s failure is against good faith and fair dealing (Official Comments for Art.7.1.3 of UNIDROIT).

**3. Blue allowed an additional period for performance to Red (Art.7.1.5 of UNIDROIT). However, Red did not perform within the period.**

In the communication on January 11, Blue allowed Red an additional period of time to deliver the Goods as soon as possible in order to meet the due date of January 31 for delivery to department stores (¶ 32)(Art.7.1.5 of UNIDROIT). However, although the chocolates worth US\$1.5 million had been taken into an aircraft, they were removed to a cargo warehouse due to a mechanical problem of the aircraft. In such a situation, it should be considered that Red’s performance was canceled. The reason is as follows.

The applicable CFR rule stipulates “*The seller must deliver the goods...by placing them on board...*” Although not expressly provided, once the goods are removed from the ship, delivery should be considered as to be canceled under CFR. If the goods are once placed on board and replaced by the seller’s will, it is obvious that obligation to deliver would be cancelled. It is also obvious that the same cancellation happens when the carrier replaced them from the ship.

If an interpretation that Red’s delivery has been performed as long as the Goods are under the responsibility of the Carrier were possible, there would be no difference between CFR and CPT (Incoterms®2010, The rule which is used irrespective of the mode of transport selected), which stipulate, “*The seller must deliver the goods by handing them over to the carrier...*” The most important principle of CFR is not handing them over to the carrier but placing them on board.

Considering above, even within an additional period, Red did not perform its obligation.

4. **Even if Red is not liable for breach by reason of its non-performance, the obligation was modified and Red did not perform it.**

Even if there were no non-performance by Red on January 10, its obligation was modified by an additional oral agreement between both parties. On January 11, Swan from Red said, *“I’ll arrange for air cargo right away”*. With this communication, both parties agreed to modify the obligation to deliver the Goods by air as soon as possible to meet the due date of January 31. Both parties should be precluded by Art.9 of the Contract, as Blue reasonably did not oppose to Red and paid by remittance for the delivered chocolates in reliance of the statement above (Art.2.1.18 of UNIDROIT). As written above, since Red did not perform the modified obligation, Red is liable for its breach.

5. **Since Red’s failure constitutes “non-performance”, Blue is entitled to claim damages of US\$1 million caused by such non-performance (Art. 7.4.1 to 7.4.4 of UNIDROIT).**

(1) According to Art.7.1.5 (2) of UNIDROIT, if due performance has not been made upon expiry of that period, the aggrieved party may have right to damages caused by such non-performance. Since Red’s failure to ship the Goods constitutes non-performance, Blue has right to US\$1 million in damages (Art.7.4.1 to 7.4.4 of UNIDROIT).

(2) In this case, since Red did not deliver the half of the Goods to Blue, Blue can claim US\$1 million for the undelivered Goods. Moreover, Blue paid US\$1 million to the department stores for an inevitable penalty ( ¶ 33), there is a reasonable degree of certainty of the harm. Furthermore, Red knew a penalty would arise if delivery had not been done when Red entered into the Contract ( ¶ 32). Therefore, Red was able to foresee that the damages would arise from its non-performance.

6. **Hence, Red should pay damages of US\$1 million.**

<Issue 2>

Summary of Blue’s Argument

【1】 As stated in Issue 1, Blue allowed Red an additional period of time for performance to deliver the Goods in order to meet the due date of January 31. However, Red did not perform it within that period. Since Red’s act constitutes non-performance, Blue is entitled to terminate the Contract for non-performance by Red. Consequently, Blue is not obligated to pay US\$1.5 million for the Goods.

【2】 There was an agreement between Red and Blue that Red would pay US\$500,000 for the airfare. Even if there were no agreement between Red and Blue, US\$500,000 for airfare is not included in the increased cost stipulated in Art.5 of the Contract (“Increased Cost”). Even if Blue were obligated to reimburse Red, the amount would be

reduced to US\$400,000.

**[1]**

**Blue is entitled to terminate the Contract for Red's non-performance.**

As stated in Issue 1, since Red did not perform its obligation within the additional period, Blue is entitled to terminate the Contract (Art.7.3.1 (3) of UNIDROIT). In addition, the requirement of *"fundamental non-performance"* in Art.7.3.1 (1) is fulfilled because the Contract was concluded in order to deliver Red's chocolate products to department stores for the St. Valentine's Day (¶ 29) and, *"strict compliance"* of the delivering date was the *"essence of this Contract"* (Art.3.3 of the Contract). Therefore, Blue is entitled to terminate the Contract.

Consequently, Blue is not obligated to pay US\$1.5 million for the Goods.

**[2]**

**1. There was an agreement between Red and Blue that Red would pay US\$500,000 for the airfare.**

In communication on January 11 between Red and Blue, Blue requested Red to pay US\$500,000 for its own cost by saying, *"later you can seek damages from Negoland Bank, which was responsible for delay"*. Red responded, *"You may be right. I'll arrange for air cargo right away"* (¶ 32). This communication formed an agreement between Red and Blue that Red would claim US\$500,000 for the airfare to Negoland Bank and Red would not allege for that fare to Blue.

**2. Even if there were no agreement between Red and Blue, US\$500,000 for the airfare is not included in the Increased Cost.**

(1) Art.5 of the Contract stipulates *"Any new, additional or increased freight rates...incurred by the Seller with respect to the Goods after the conclusion of this Contract, shall be for the account of the Buyer..."*.

(2) However, US\$500,000 in this case does not correspond to *"Any new, additional or increased freight rates"*.

The Contract presupposes marine transportation. Thus, the *"Any new, additional or increased freight rates"* should be limited to marine transportations such as increased cost incurred by an unavoidable change in the sea route. In this case, US\$500,000 in damages has incurred because the mode of transportation has changed. Therefore, the cost US\$500,000 in this case does not correspond to *"Any new, additional or increased freight rates"*.

**(3) Moreover, US\$500,000 for the airfare was attributable to Red's non-performance and does not correspond to Increased Cost.**

Increased Cost does not include costs incurred unjustly to cover Red's mistake. Therefore, US\$500,000 for the airfare that was attributable to Red's non-performance is not included in Increased Cost.

Hence, Blue is not obligated to pay US\$500,000 for the amount Red paid to Negoland Air.

**3. Even if Blue is obligated to reimburse to Red, the amount should be reduced to US\$400,000.**

Art.5 of the Contract is a provision that determines responsibility for costs that have increased. The increased cost in this case is US\$400,000, which is calculated by US\$500,000 for the airfare minus US\$100,000 for shipping fee. Thus, the amount Blue is obligated to reimburse to Red is no more than US\$400,000.

## **M&A Case <Issue 1>**

### **Summary of Blue's Argument**

Blue represented and warranted the correctness of matters stipulated in Art.4.1 of the Stock Purchase Agreement (the "SPA"). However, Blue is not in breach of its obligation stipulated in Art.4.1 (xiii) of the SPA.

Even if there were a breach of Art.4.1 (xiii) by Blue, Red cannot claim damages under the principle of good faith.

**1. Blue represented and warranted the correctness of matters stipulated in Art.4.1 of the SPA.**

Blue represented and warranted the matters stipulated in Art.4.1 of the SPA. Although Blue does not breach its obligation in relation to any item stipulated in Art.4 of the SPA, the item (xiii) "*No Adverse Change*" should be elaborated as follows since Red is expected to rely on the item.

With Art.4.1 (xiii) of the SPA, Blue represented and warranted as of December 15, 2012 and as of the Closing Date, that there was no adverse change in the condition of the TARGET or its business or the assets of the TARGET and no such change is threatened to the TARGET or its business (Art.4.1 (xiii) of the SPA).

The adverse change should mean an event that has substantial negative impact on business and to be reported on financial statements or to affect the numbers or descriptions in the financial statements. The reason is as follows.

Red could know the condition of the TARGET until the fiscal year 2011 with the financial statements provided by Blue, but not that after 2012. Item (xiii) is for Red to know if there

is any negative change that should be reflected in the financial statement after December 31, 2011.

**2. Blue is not in breach of its obligation stipulated in Art.4.1 (xiii) of the SPA.**

There was no adverse change on the condition, financial or otherwise, of the TARGET or its business or the assets of the TARGET and such change was not threatened to the TARGET or its business.

**(1) There was no adverse change.**

In 2012, Blue Drink received complaints from select consumers linking overconsumption of Blue Slim to stomach problem. Also, Blue Drink received the warning from the Ministry of Health and Welfare (the “Ministry”) in early 2012 (¶39). However, as a result of a series of rigorous tests conducted by Blue on Blue Slim, no particular stomach problem was found and it was scientifically proved that there was no problem with the quality of the product (¶39). Moreover, the sales volume did not decrease in the fiscal year of 2012 (Exhibit 2). That is, the corporate value and the reputation of Blue Drink were not affected. Thus, the complaints and the warning from the Ministry did not have actual negative impact on the management of the Blue Drink’s business. Therefore, as of the Closing Date, there was no adverse change to the condition, financial or otherwise, of Blue Drink’s business.

**(2) No adverse change was threatened to the business of Blue Drink.**

As stated in (1), it was found that there was no problem on the quality of Blue Slim. More than one year had passed since the execution of the SPA when Blue Slim was revoked its “Designated Health Food” status, on April 30, 2014 ( ¶ 39). Thus, as of the execution of the SPA and as of the Closing Date, no adverse change was threatened to Red Drink and its business.

Therefore, Blue is not in breach of Art.4.1 (xiii) of the SPA and all other items listed in Art.4.1 of the SPA as well.

**3. Even if there were a breach of Art.4.1 (xiii) of the SPA by Blue, Red is not entitled to claim damages.**

Art.4.2 of the SPA stipulates that Blue should bear the responsibility for the violation of the representations and warranties. However, in this case, Red is not entitled to claim damages under the principle of good faith (Art.1.7 of UNIDROIT). The function of representations and warranties is to protect a buyer who cannot know all the risks through the Due Diligence (the “DD”), such as the risks that are undisclosed to a buyer in the course of the DD. However, when a buyer is aware of the adverse change of a target, a buyer may

protect him/herself by making a request to reduce the purchase price or to include additional provisions to cover risks during the negotiation for dealing. Considering the relation between the DD and the representations and warranties, claiming damages ex-post facto, where Red concluded the contract knowing these events is against the principle of good faith. In this case, Blue had disclosed the complaints and the warning from the Ministry to Red in the course of the DD (¶ 39, Exhibit 13). Moreover, Pat Red, the president of Red, said, “they didn’t find any issue that stands in our way” and did not ask Blue to be reflected on the deal (¶ 19, 21). In these circumstances, under the principle of good faith, Red should be precluded to argue Blue’s breach of the representations and warranties relying on the fact that Blue did not make the notice of the complaints and the warning from the Ministry on the date of the SPA.

**4. Even if Red is entitled to claim the damages, Red’s claim for the damages should be rejected.**

The claimant owes the burden to prove that there is a causal relationship between a creditor’s damage and the non-performance of an obligor. From the fact that Red had already known the complaints and the warning from the Ministry, it is clear that Red purchased Blue Drink anyway notwithstanding whether the notice of the complaints and the warning had been done by Blue or not (¶ 39). Thus, the Red’s loss was not the result of Blue’s breach of Art.4.1 (xiii) of the SPA, but due to Red’s business judgment that purchased the TARGET even though the TARGET had received the complaints and the warning from the Ministry on Blue Slim. Therefore, there is no causal relationship between the damage and the breach. Hence, Red’s claim for damages should be rejected.

**<Issue 2>**

**Summary of Blue’s Argument**

Blue had an obligation not to run a business similar or competitive to that of the TARGET. However, Blue did not breach the non-competition clause stipulated in Art.9 of the SPA dated December 15, 2012.

Even if there were a breach of Art.9.1 of the SPA, Blue ought not to withdraw the investment US\$5 million to Arbitria Coffee. Moreover, the liquidated damage which Blue is liable to pay should be reduced.

**1. Blue had an obligation not to run a business similar or competitive to that of Red Drink.**

Art.9 of the SPA prohibits competition by stipulating, “Blue shall not and Blue shall not allow its affiliates to, directly or indirectly own, manage, operate, control, participate in, perform services for, or otherwise carry on a business similar to or competitive with the business conducted by the TARGET in Arbitria or Negoland”.

## **2. Blue did not breach its obligation.**

### **(1) The business of Arbitria Coffee is not similar to or competitive with that of the TARGET.**

The TARGET conducts soft drink business, but not coffee drink business (¶ 9, 37). The coffee drink business is not similar to that of the soft drink, since their beverage categories differ from one another. When consumers purchase drinks, they first decide the category of drinks (soft drink, coffee or tea) and choose what to drink. The coffee drinks and the soft drinks do not compete with each other since consumers purchase those items in different occasions. Therefore, Red Drink would not lose its customers even if Arbitria Coffee develops coffee with weight loss benefits. Considering those facts, the business of Arbitria Coffee is neither similar to nor competitive with that of the TARGET.

### **(2) None of Blue's acts corresponds to the violations stipulated in Art.9.1 of the SPA.**

The purpose of the non-competition clause is to prohibit Blue or its affiliates to cause the loss of value of the TARGET due to the substantial contribution to the business that is similar to or competitive with that of the TARGET. It is clear that Blue's acts do not constitute "*own, manage, operate, control*" the business of the TARGET. Red might allege Blue participated in or performed services for the business of Arbitria Coffee in breach of Art.9.1 of the SPA. However, considering the purpose of this clause stated above, either "*participate in*" or "*perform services for*" prohibit acts which may contribute to the business that is similar to or competitive with that of the TARGET.

In this case, there are no acts by Blue in breach of Art.9.1 of the SPA. Blue acquired Arbitria Coffee's stock by investing US\$5 million, sent a non-executive director and lent a part of the Central Research Center (¶ 36). However, the stock Blue acquired composes only 20% of the share of Arbitria Coffee. Considering the fact that the CEO family owned 56% of its share, Blue does not have influence on the business. Moreover, sending a non-executive director was not an act intended to participate in the decision-making of the business. Furthermore, the lending of the Central Research Center was a commercial rent for half a year and not a single employee of Blue was involved in the development. Abovementioned acts do not contribute to the development of coffee with weight loss benefit. Therefore, Blue is not in breach of Art.9.1 of the SPA.

### **(3) Arbitria Coffee is not an affiliate of Blue.**

Red may argue that Arbitria Coffee is an affiliate of Blue, but it is not the case. Since Art.9 of the SPA stipulates Blue's obligation, the subject of this article is Blue, an Arbitrian corporation. Thus, regarding the definition of affiliate, the Companies Act of Arbitria should be applied. The Companies Act of Arbitria defines the term "affiliate" as

“company on which another company may exercise substantial influence over financial and business policy decisions” (¶ 37). In this case, Blue got 20% share of Arbitria Coffee and sent a non-executive director. However, since the CEO family is the largest stockholder who still holds 56% of its share, Blue does not have any meaningful influence on Arbitria Coffee’s management. Also, one non-executive director cannot influence the management of Arbitria Coffee.

Consequently, since Blue does not have strong influence over financial and business policy decisions, Arbitria Coffee is not an affiliate of Blue.

For the above reasons, Blue is not in breach of the non-competition clause stipulated in Art.9 of the SPA dated December 15, 2012.

**3. Even if there were a breach of Art.9.1 of the SPA, Blue is not obligated to withdraw the investment US\$5 million to Arbitria Coffee.**

Art.7.2.2 (a) of UNIDROIT states, “Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance, unless (a) performance is impossible in law or in fact”.

Red claims that Blue shall withdraw the investment to Arbitria Coffee. However, Arbitria Coffee’s consensus to repurchase its stock is required in order for Blue to withdraw the capital investment and it is practically impossible to get such consent from Arbitria Coffee, not a party of this proceeding, and the one who has capital requirements, to withdraw the capital once invested. Therefore, Blue does not have to withdraw the investment to Arbitria Coffee since it is impossible in fact.

**4. The liquidated damages shall be reduced.**

Art.7.4.13 of UNIDROIT states, “...The specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances”.

In this case, Art.9.2 of the SPA stipulates US\$500,000 as liquidated damages in case Blue is in breach its obligation stipulated in Art.9.1 of the SPA. However, there has been no damage caused by Blue’s breach of Art.9.1 of the SPA. The designated amount was excessively high comparing to the actual damages, that is zero. Therefore, the amount of liquidated damage should be totally or reasonably reduced.

**<Issue 3>**

**Summary of Blue’s Argument**

Red had an obligation not to materially harm the interest of Blue in the additional payment as stipulated in Art.2 of the SPA. However, Blue’s interest was materially harmed because of Red’s breach of its obligation on Art.8. Therefore, Red has an

obligation to pay US\$200 million in damages.

**1. Red had an obligation not to materially harm the interest of Blue in the additional payment as stipulated in Article 2 of the SPA.**

Art.2.2 of the SPA stipulates that, when EBITDA of Red Drink in the fiscal year 2013 and/or 2014 exceeds US\$110,000,000, Red shall pay to Blue equals EBITDA×8 as the contingent payment. In addition, Art.8 of the SPA stipulates that Red shall not materially harm the interest of Blue in the additional payment as stipulated in Article 2.2 of the SPA.

**2. Blue's interest was materially harmed because of Red's breach of its obligation in Art.8 of the SPA.**

Red signed the distributorship agreement with Nego Drink at unreasonably low standard retail price and created circumstances for Orange to leave (¶ 25, 35). As a result of these non-reasonable business judgments, Blue lost its interest in additional payment, US\$200 million in total in 2013 and 2014. US\$200 million is equal to 25% of the upfront price and is obviously a material amount for Blue. The loss of US\$200 million had occurred due to Red's non-reasonable business judgments.

**(1) Red Drink signed the distributorship agreement with Nego Drink.**

Red signed a distributorship agreement with Nego Drink at 40% of standard retail price and it was not reasonable business judgment. Red had negotiated with Negoland Bottlers and Nego Drink as candidates for a distributor in Negoland (¶ 23,24).

Negoland Bottlers, which has the same sales force as Nego Drink, offered 50% of standard retail price, which is 10% higher standard retail price than that of Nego Drink. However, Red did not continue its effort to negotiate with them in spite of the possibility to conclude the contract with better conditions. Moreover, Red did not hold the competition to get better condition from both candidates. Red's decision to conclude a contract with Nego Drink was far from the business judgment that a reasonable business person would have made. Therefore, the decision Red made cannot be considered as a reasonable business judgment.

**(2) Bob Orange resigned from Red Drink.**

As a result of Orange's resignation from Red Drink, Red Drink lost US\$600 million (Exhibit 17). Orange was a director in charge of R&D department at Red Drink and a well-known person among the beverage trade (¶ 35). Red knew Orange was crucial for Red Drink's success in business (¶ 20). Also, Red understood that as long as there was an adequate R&D budget and appropriate environment Orange remained at Red Drink (¶ 20).

Originally, Orange was allowed to have a period of three months for the improvement of the products ( ¶ 27). However, Red Drink suddenly abridged the period for improving products from three months to two months, refusing Orange's request for 20% of increase of the R&D budget, which was a reasonable amount of US\$100,000 ( ¶ 27, 35). From these facts, it was clear that Red Drink created the circumstances that Orange had no choice but to resign. The resignation of Orange caused lackluster sales of Red Slim and Red Energy. Moreover, the improvement of products stopped and no one could correspond to the Ministry of Health and Welfare when Red Slim's "Designated Health Food" status was revoked ( ¶ 38).

As a result, Red Drink lost US\$600 million as a result of Red's repeated non-reasonable business judgments. Comparing the lost benefit US\$600 million to US\$100,000 which Orange requested for its R&D budget, it is clear that not accepting the increase of the R&D budget was totally not a reasonable business judgment.

**3. Therefore, Red has an obligation to pay US\$200 million in damages.**

If Red had not made non-reasonable business judgment as mentioned above, EBITDA for a fiscal year 2013 was US\$120 million and that of 2014 would be US\$125 million and Blue could have received US\$200 million (25 million×8) by Red (Exhibit 7,16). In addition, Red had acknowledged the damages in case Red breached Art.8 of the SPA (Art.7.4.2 to 7.4.4 of UNIDROIT).

Hence, Red is obligated to pay US\$200 million in damages (Art.7.4.1 of UNIDROIT).