Tenth Intercollegiate Negotiation Competition Problem
(Oct. 3, 2011 version)

Note: This problem is subject to further change, as questions raised by participants will be incorporated into the final version, which will be announced in early November.

1. The Federal Republic of Negoland is a parliamentary democratic nation with a population of 80 million. It has an advanced industrial capacity, particularly in the fields of automobiles, machinery, electrical and electronics, chemical, environmental technology, precision machinery, optical equipment, medical technology, biotechnology, nano-technology, aerospace, and logistics, among others. Its GDP in 2011 is about US$2 trillion. A number of corporations in Negoland are known for their international competitiveness, which rests on the country's established reputation for high technical standards and reliable goods and services. In recent years, however, Negoland's price competitiveness in the global arena is viewed as eroding, due to rising labor and production costs, caused by escalating inflation and wage levels on the back of its economic development. In fact, a growing number of corporations in Negoland are shifting their production bases in part or in whole overseas, in search of a more inexpensive workforce.

2. Negoland has been running a fiscal deficit ranging from 8% to 10% of its GDP in recent years. Its accumulated governmental deficit now stands at about 100% of its GDP, which is partially the result of governmental measures taken to spark the faltering economy in the aftermath of the Lehman crisis. Harmony, who became the prime minister of Negoland in 2010, said that cutting the deficit would be an important issue for his administration. In 2011, a leading rating agency downgraded Negoland's sovereign bonds from AA to AA-, a decision based on the fact that no improvement in reducing the fiscal deficit had been seen. As a measure to reduce the fiscal deficit, Harmony has been calling for the end to the preferential tax treatment accorded to corporations and wealthy individuals, but he has met with strong opposition from the business community and has been unable to implement any measures.

3. Arbitria is a democratic republic with a population of 70 million. Its economy has undergone rapid development in the last 25 years or so. Arbiria's GDP in 2011 is about US$800 billion. It has advanced industrial sectors including electrical and electronic devices, automobiles, shipbuilding, iron and steel, and petrochemicals, among others, and a number of large corporations there have expanded globally. The government of Arbitria has emphasized education, beginning from a young age. This policy has led to an outstanding and yet relatively inexpensive labor pool, which in turn has contributed to its economic development. Apple, who was inaugurated as the president of Arbitria in 2008, ran for the presidential race and won it after serving as Congressman for 5 years. Prior to that, he was the president of Blue Corp., one of Arbitria’s leading companies. He is known for his knack for successfully tackling economic issues. During the Lehman crisis, Arbitria's economy did not plunge severely thanks to the appropriate policies initiated by Apple. Apple's

term of office will expire in 2012, but most people expect him to be re-elected.

4. The government of Arbitria focuses strongly on attracting investment from abroad, and it has implemented an incentive scheme for foreign investment. In particular, as part of its incentive scheme to attract foreign investment in the sphere of advanced technology, foreign investors who make authorized investments in the fields of the electronic & electrical sector, precision machinery sector, new materials & precision chemicals sector, environment/energy/resources sector, and construction/infrastructure sector are exempted from enterprise and income taxes for the first five years and may be eligible for special reduced tax rates for three years thereafter by filing an application.

5. Negoland and Arbitria border each other. The two nations have concluded a free trade agreement, imposing no tariffs on trade between the two countries with the minor exception of select food items. The two countries are actively engaged in trading both goods and services with each other. Companies in the two countries are also very active in forming partnerships and tie-ups with one another. Aside from these connections, Nego companies invest actively in Arbitria by taking full advantage of the above foreign investment incentives offered by Arbitria. Exhibit 1 is the pertinent part of chapter 10 on investment in the free trade agreement between Negoland and Arbitria. Please note that the sections not given in Exhibit 1 have no relevance to the problem.

6. Red Corp. is a large corporation in Negoland engaged in the manufacture and distribution of chemicals, resins, textiles, housing/construction materials, electronics, and pharmaceuticals/medical devices, among others. Originally founded as a textile concern in 1931, Red has steadily grown in size and expanded its business lines in response to the changing requirements of the times. It has manufacturing and sales locations in 15 countries and has set its eye on overseas business expansion. In Arbitria, Red already has a factory for plastics and other resin products and a wholly owned subsidiary, Red Arbitria, which serves as a distribution base handling products by Red. Red is outlined in Exhibit 2.

7. Blue Corp. is a leading company in Arbitria. This large company delivers information and communication systems and infrastructure in addition to the manufacture and distribution of construction machinery, industrial equipment, electronic parts and home appliances, among others. Blue was founded in 1910 as a home appliance manufacturer; it has grown in size steadily since then. Today, Blue enjoys a global reputation not only as a manufacturer and distributor of home appliances and industrial equipment but also as a company engaged in the development and delivery of information and communication equipment as well as corporate production management systems and social infrastructure systems that leverage cutting-edge IT technology as well as infrastructure. It has a network of business locations in thirty countries around the world; in Negoland, it has a wholly owned subsidiary called Blue Negoland and manufacturing facilities for high-performance electronic parts. Blue is outlined in Exhibit 3.

8. In July 2009, in a move to boost production capacities for its synthetic fiber products, which are expected to see greater demand, Red decided to build a new factory for synthetic fiber products, in addition to three factories for synthetic fiber products that currently exist in Negoland, US and Japan. The City of Abshore in Northern Arbitria was selected as the candidate location for the new factory. Abshore was selected because of the outstanding and yet relatively inexpensive (compared with Negoland) workforce and the zero-tax environment for foreign investors thanks to Arbitria's foreign investment incentive scheme, as well as the nation's political and economic stability and the high level of enthusiasm extended by the City of Abshore to invite Red's new factory.

9. In 2009, Red felt that production management systems for factories used in its domestic and overseas locations needed revamping. Many of Red's key factories still rely on production management systems introduced around the year 2000. Red was aware that certain issues should be addressed on a company-wide basis, including a production structure capable of responding quickly to customers' orders to cope with intensifying global competition, cost slashing by minimizing inventories of raw materials and finished goods, and stricter cost management. Therefore, when the construction of the new Abshore factory came up on the agenda, it wanted to introduce some cutting-edge production management system there to ensure quick and appropriate handling of customers' orders, to eliminate unnecessary inventories, to undertake advanced product quality control with traceability for defective goods, to facilitate financial and cost accounting, and to manage the entire system encompassing all of the above on a real time basis, not only from on site in Arbitria but also from the head office in Negoland via the web. Red wanted to install such a system at the Abshore factory first, and, based on the evaluation of the system performance there, the Company would decide whether a similar system should be launched at other factory locations.

10. Red approached several companies in Negoland about the development of a production management system for the Abshore factory, and it shortlisted its candidates to Purple Corp., a Negoland company. Red and Purple discussed system requirements desired by Red and other matters needed for the preparation of the system including manpower, days and budget. As a result of the discussions, Red and Purple signed a system development agreement in October 2009.

11. Red embarked on preparatory work for the Abshore Factory construction project with a total budget of US$20 million. Its target completion date was May 2011, to coincide with the Company's 80th anniversary. Purple too, began its work for the development of the system for the Abshore factory. During a conference held on October 31, 2009, Red and Purple reached an agreement on nearly all matters regarding the basic system architecture. Exhibit 4, an excerpt of the confirmation memorandum, sets forth the matters the two companies agreed upon during that meeting (Please note that any part of the memorandum not given in Exhibit 1 has no relevance to the problem). Under the agreement, Purple was to draft a basic design plan. But Purple went bankrupt on November 5, 2009, due to some failed investments. Purple's bankruptcy prompted Red to urgently

look for and engage another company to develop a production management system for its Abshore Factory.

12. Red contacted a few companies in Negoland but was unable to find one willing to fill the role of developing the system once played by Purple. Its search for a system developer was extended to companies in Arbitria, where the production system would be put in place anyway, and the expanded search resulted in a potential candidate, Blue Corp. On November 20, 2009, the persons responsible for this project, Bob Orange, Senior Executive Director in charge of the textile and materials business, and Ross, the director in charge of the chemical product division, visited Blue and met with Hiro, the director of Blue's industrial system business division, and Tolly, the person who would be tasked with the relevant work.

13. During the meeting on November 20, 2009, the following conversation took place between the parties.

Orange: For our Abshore factory, which is under construction now, we plan to use the latest production management system. We asked Purple Corp. in Negoland for the development of a system but Purple went bankrupt. Now, we are thinking about asking you to replace Purple and develop a system for us.

Hiro: We are definitely interested in the work. Please tell me more about the system you wish to develop.

Ross told them the following while showing the agreement between Red and Purple and the Confirmation Memorandum, which appears in Exhibit 4.

Ross: Here is the agreement we concluded with Purple. In late October, we reached an agreement with Purple regarding the basic architecture of the system, and these are the memorandum describing that meeting. We want the new system to help us respond more quickly to customers and reduce inventories, and we want it to ensure advanced quality control, smoother financial and cost accounting, and a high degree of system operability via the Web. We will consider introducing the system throughout the company, but that will depend on the performance results of the initial launch at Abshore.

Hiro and Tolly, having read the agreement between Red and Purple and Exhibit 4, responded as follows.

Hiro: Now I understood your needs very well. Thank you for choosing us. You have reached an agreement with Purple regarding the basic architecture of the system. Am I correct to assume that, should we decide to work for you for this project, we will be able to come up with our version of system architecture?

Orange: Do you have anything specific in mind?

Hiro: Yes. We are able to give you a system far superior to Purple’s even at the same cost, if our operating system and new products, among others, are used.

Orange: Really. A far better system than Purple's and yet for the same cost? That would be quite attractive. Well, please prepare your proposal along those lines and give it to us as

soon as possible. We want to review it before making a decision.

14. On December 5, 2009, Hiro and Tolly visited Red Corp. to meet with Orange and Ross. Hiro and Tolly gave Orange and Ross a proposal document, which appears in Exhibit 5, and told them the following:

Hiro: Here's our proposal. It was drafted based on the functional requirements stipulated in the agreement between you and Purple. And as such, no major difference exists between our proposal and that of Purple's, as far as the basic system architecture is concerned. What's more, our operating system is far superior to Purple's in terms of performance; ours can process data 1.5 times faster. And ours supports five different languages. The agreement with Purple sets the underkill rate of the defective products (the rate of misclassification of defective products as non-defective products) with respect to defective goods at 1%. But it is possible for you to aim at a better underkill rate in the range of 0.3% to 0.5% to secure higher product quality, if you agree to use our Blue Tester, which is automatic defect inspection equipment manufactured by us, in conjunction with the system. It allows us to develop a system targeting that rate.

Ross: That will be wonderful. How about pricing?

Tolly: The price depends on man-hours; the system detailed in our proposal is priced at US$5 million, the same price quoted by Purple.

Orange: The price is attractive, indeed. I will take your proposal back to the office, and will reply to you as soon as we can after reviewing it.

Tolly: As for accounting standards, which set of standards do you use? We can set your system up to be compliant with the International Financial Reporting Standards (IFRS), the USGAAP or the generally accepted accounting principles of Negoland, among other choices.

Orange: Well, as far as I know, my country only permits us to use the generally accepted accounting principles of Negoland, so the system must be compliant with Negoland's generally accepted accounting principles.

Hiro: Oh, is that right? Well, we are able to slash costs by 10% or so for IFRS-compliant systems, because our country uses IFRS, but for you, we will prepare a system that complies with the Nego accounting standards.

Ross: Would it be difficult to switch from Negoland's generally accepted accounting principles to IFRS later?

Tolly: Well, I believe it isn't too difficult. Would you like me to confirm this?

Orange: No. There is no need to confirm it.

As of 2009, all listed companies in Negoland were required by law to adapt Negoland's generally accepted accounting principles. In contrast, Arbitria allowed listed companies to choose either Arbitria's generally accepted accounting principles or IFRS.

15. Having returned to the office, Orange and Ross immediately proceeded to consult with the

related departments within Red to examine Blue's proposal. Also, they contacted Yellow Corp., the company engaged in the construction of the Abshore factory, and told Yellow Corp. of Red's then plan to hire Blue for the development of its production management system, and sought Yellow's confirmation. Yellow told them that the change in the party developing the system would not hamper the wiring and network-related work on a major scale, as long as no change would be made in the basic system architecture. Red relayed Yellow's reply to Blue and had Blue explain to Yellow how Blue's plan differed from Purple's in terms of the basic system architecture. Yellow understood the explanation and confirmed that, if things were as explained, it would cause no major trouble.

16. Moreover, Red searched among clients of Red Arbitria, found a few clients in Arbitria with recent experiences with Blue's systems and conducted reference checks. These clients all told Red that they were "very satisfied." Based on the results of discussions and examinations described above, Orange and Ross decided in principle to sign a deal with Blue. They said the following to Nomura, the president of Red:

"We have investigated the matter from various angles and we've decided to use Blue to succeed Purple and ask Blue to develop a production management system for us. Their price is the same as Purple's but Blue's system will offer better performance."

Nomura said to Orange, "1.5 times faster processing speed plus a better underkill rate for the same price as Purple's is attractive. All right. You can go ahead with the plan as you just described in principle."

17. On December 15, 2009, Orange and Ross visited Hiro and Tolly at Blue with the intention of communicating Red's decision.

Orange: Thank you for your proposal. We carefully reviewed your proposal and decided to ask you to do the work for us. Nomura, our company president, also told me that we would like the processing speed that is 1.5 times faster than Purple's and a better underkill rate than Purple's for the price of US$5 million. Due to the bankruptcy of Purple, our work has been delayed. I request that the development work be started in a rush.

Hiro: Thank you for your consideration. We'll do our best. You just said "rush," but when would you like to have it delivered?

Orange: We expect that demand for our products will grow further. Currently, our factories are already running at full capacity, but facilities are getting obsolete and are in dire need of maintenance and inspections. For these reasons we need to put the new factory in service as soon as possible. Also, our 80th anniversary is May 2011. We plan to have a big celebration on May 1, 2011 to mark our anniversary, and we want it to coincide with the operational launch of the new factory equipped with the latest equipment so that we will be able to throw a double gala event for the corporate anniversary and for the operational launch of the factory.

Hiro: Our standard work process begins with the preparation of a statement of work, basic

design, then design of details, followed by programming and testing. For a system of this size, there will be many issues that need to be discussed with you. Also, we will have to conduct solid reviews at each phase, and we would appreciate a bit more time.

Orange: The construction of the factory itself is under progress, and we do not have much time left. Can you complete it in line with our timeframe?

Hiro: I understood your points. We'll do our best. However, as I said before, we need your cooperation - we may have to visit you for one reason or another, and we may need to consult with you for a variety of issues.

Orange: All right.

Hiro: By the way, would you like to have our Blue Tester installed?

Orange: Yes. We would love to have it. The price of Blue Tester is included in the US$5 million, right?

Tolly: No, it is not included. The US$5 million is the fee we charge for the system development, and for Blue Tester, you will be charged an additional US$1 million, which will cover the purchase of the inspection equipment.

Orange: What? You've never mentioned it to us.

Tolly: Is that so? If your budget is limited, you are free to choose inspection equipment other than Blue Tester, but for any inspection equipment, you will be charged separately. We will develop a system in conjunction with the inspection equipment of your choice.

Orange: Can't you give us a better price?

Hiro: Blue Tester is a new product, and no one is offering it at a discount.

Ross: There should be a way around that, right?

Hiro: I am sorry.

Orange: In that case, I don't know what to do. I need to discuss this matter with Nomura once again.

18. Orange returned to Red Corp. and reported to Nomura, the president.

Orange: I told you about Blue Corporation a while ago. Now there is a little change to the story I told you before. They now tell me that we will need to pay an additional US$1 million, on top of the US$5 million, for Blue Tester inspection equipment made by Blue, in order to achieve a better underkill rate. Under the original agreement with Purple, we planned to use the testing equipment by Mellon Corp., which has a price tag of US$500,000. Blue Tester costs twice as much. In addition, in the agreement with Purple, this US$500,000 was included in the contract price of US$5 million. What should we do?

Nomura: Don’t give me that nonsense now. Go back to Blue and make them say yes to the price we are willing to pay. That shouldn’t be so difficult.

Orange: I asked them, but they refused. This is a new product and no one is offering a discount for it.

Nomura: If Blue gives us that excuse now, we don't have to do business with Blue.

Orange: But if we do the search from scratch all over again now, we won't meet our timeframe.

Nomura: Well, I guess there's no way out. If we can't get a discount, let's use the inspection equipment you originally planned to use under the agreement with Purple. After all, our planned underkill rate was 1% when we discussed it with Purple.

19. Orange phoned Hiro.

Orange: Are you really not able to give us a discount? Under the agreement with Purple, we planned to use the equipment made by Mellon, which costs us US$500,000. Is there any way to slash the price of your equipment to US$500,000?

Hiro: My apologies. It would be extremely difficult. To make up for this, we'll do super fine jobs at programming.

Orange: Well, I see. Then, please use the inspection equipment by Mellon Corp. Here are the terms: the price for the program will be US$5 million, the price for the inspection equipment will be US$500,000 and the operational launch will be May 1, 2011. Please go ahead.

Hiro: Thank you very much. We have a standard contract form. I will draft a contract based on it and will bring it over to you.

Orange: All right. Thank you.

20. On January 10, 2010, Red and Blue signed a contract, which appears as Exhibit 6 (Please note that any part of the memorandum not given in Exhibit 6 has no relevance to the problem). The agreement was based on the standard contract prepared by Blue for system development agreements and was drafted by filling in the Schedule section with the specific details agreed upon for the current case. The draft of the agreement was delivered by Blue to Red by e-mail on January 8.
The agreement was signed by Orange and Hiro on behalf of Red and Blue, respectively. When signing, the following exchanges took place between the parties.

Orange: Based on the schedule mentioned here, somehow I guess it will be ready in time for the anniversary.

Hiro: I think so. You are in a rush, so we decided to use what Purple has done where usable. Basically, we normally spend at least a month to test these types of systems, but we decided to allocate 1.5 months.

21. After signing the agreement, Blue embarked on system development work. On January, 2010, Red paid US$1 million to Blue according to the agreement as shown in Exhibit 6. On February 3, 2010, Blue made an inquiry to Red in order to understand the data needed in conjunction with production management work to be handled by Red in Negoland, as well as their requirements as to operational authority and security.

Tolly: In order to design your system, we need to know what information and data you will require and your opinions about how we ought to set up operational authority and security. I hope you will cooperate by submitting your answer to us.

Ross: I see.

However, Ross made the following reply to Tolly on February 7.

Ross: I am sorry but the person tasked with this project is on sick leave. Can you wait a little while?

Tolly: I see. But that will affect the progress of our work. Please give us your reply as soon as possible.

On February 10, Ross contacted Tolly and said the following:

Ross: We are still ironing out the difference of opinions among our production control division, the general administration division and the systems development division regarding operational authority, and we need more time to come up with an answer.

Tolly: Any further delay will definitely impact our work process. The schedule, as it stands now, is already pretty tight.

Ross: Delay will give us a great deal of trouble. As I told you before, we are having a commemorative ceremony on May 1 and we need to be ready by then. You can catch up somehow, right? Please wait a bit more; it won't be too long. If there is anything else you can do now, please start right away.

Tolly: There's nothing I can do about your delay. We can probably still absorb a certain degree of delay, as the testing period in the schedule we came up with has a little extra time as a buffer. We will work hard but you need to rush.

Red finally gave Blue the reply it needed on February 25.

Ross: Sorry for being so late.

Tolly: We have received your reply. But we are behind schedule, because we didn't get your reply for a long time.

Ross: Delay will give us a great deal of trouble. Can't you do something about it so that there will be no delay in the end?

Tolly: I'll ask our team to work overtime to catch up, but it may involve an additional cost, which will be passed on to you. Please tell Orange about this.

Ross: I see.

Ross talked to Orange detailing the above exchanges.

22. On March 10, 2010, Blue delivered the Statement of Work to Red. Hiro, who made a visit to Red, personally delivered the plan to Orange.

Hiro: We managed to come up with this Statement of Work without too much delay. Please confirm the details carefully.

Orange: Thank you very much. I guess the project is making progress without experiencing a major delay, in spite of the tight schedule.

Hiro: We did not hear from you for a long time regarding the questions we asked. And this affected our work process and we had to overextend ourselves. We managed to handle the situation this time somehow, but we don't have any extra time left and cost-wise, we have no more leeway either. I hope you will cooperate.

Orange: I know we caused you trouble. Our man in charge of the project was sick and we had

difficulties coordinating opinions among ourselves. I thank you for giving us this Statement of Work without a great deal of delay.

One week later, Red approved this Statement of Work.

23. On May 10, 2010, Blue sent a draft of the basic design plan which was made based on the Statement of Work. However, on May 20, 2010, Red contacted Blue.

Ross: I had Yellow guys take a look at the basic design plan you gave us. They told us that their wiring and network plans might require major modifications, if the system to be incorporated is as mapped out in the design plan.

Tolly: I don't understand why this problem has occurred. You did talk to Yellow about it in advance and they did confirm it, right?

Ross: We did confirm with Yellow that no major difference existed between Purple's and Blue's basic plan. But the system will not function properly because the explanation provided by Purple to Yellow initially was wrong. It's the responsibility of none other than Purple. But in any event, adjustments must be done both for the wiring and network installation work by Yellow and for the system development work you are carrying out at Blue.

Tolly: Is there any other remedy?

Ross: We asked Yellow about that many times, but there is no other way out. We've got to change them.

Subsequently, Red, Blue and Yellow discussed possible steps to be taken.

Orange: I feel sorry for the people at Blue and Yellow, but work must go on and we must work harder to get things done.

Yellow: There's nothing I can do about it. We'll do our best as far as the part we are responsible for is concerned.

Hiro: There is no other way out, right? But that will require a good amount of cost and time.

Orange: How much more time?

Yellow: We are OK.

Hiro: Can you give us one month or so?

Orange: A delay of one month! It won't be ready for the operational launch on May 1 of next year. Do something about it, please.

Hiro: We'll try but a delay of two weeks or so is unavoidable, so we will have to cut short the testing period. Also, we very much need your cooperation.

Ross: We'll do anything within our capacity. It is extremely vital for us to have it ready by May 1 of next year. If there is anything you need to meet the deadline, please feel free to tell us.

Hiro: We'll do our best. And an additional cost will be incurred because we expect a sizable addition to the initially projected man-hours.

Orange: How much increase do you have in mind?

Hiro: I don't know how many extra man-hours will be needed until it gets done, but I believe a certain degree of extra man-hours is unavoidable.

Orange: I see. I beg you to work hard to meet the May 1 deadline.

After the above exchanges, Blue changed the design and submitted the revised version of the basic design plan on June 10. With respect to the revised plan, Yellow said it did not see any problem, and Blue proceeded to the next step of designing details.

24. On June 20, 2010, Nomura, the president of Red, and Ohta, the president of Blue, were both in Arbitria to attend a gathering of Nego and Arbitrian corporate executives. The two took this opportunity to discuss their business relationship over dinner. Orange and Hiro were also present at this meeting.

Nomura: You are helping us a great deal for our Abshore factory. We want to make it our leading factory by installing a cutting-edge production management system. Depending on how well the system will perform at Abshore, we may use the system at other factory locations of ours.

Ohta: Thank you for giving us such an excellent opportunity. We are doing our best to make the system ready for your ceremony on May 1 of next year.

Nomura: Thank you very much. Well, I have a request concerning Abshore. In the last week, it is decided that, in Negoland, we will be able to choose between our country's own accounting standards and the IFRS, beginning from 2011. We plan to adopt the IFRS on this opportunity. Therefore, the system you are developing now needs to be IFRS compliant. According to Orange, your organization told us that your system can easily accommodate the IFRS and that IFRS-compliant systems cost about 10% less.

Ohta: Really? Hiro, any opinion?

Hiro: We have no problem setting the system up to be IFRS ready. But we've finished the basic design, which reflects Negoland's accounting standards, and besides we already began our work on design details. To make it IFRS compliant now, we need to modify the design. That will also entail some modification in terms of timeframe and cost.

Nomura: What do you mean by “some modification”?

Hiro: In terms of time, we probably need an extra month or so. As for the additional cost, it will depend on how much time and labor the change will require, and I don't have any idea off hand. I have to calculate it. In some cases it may require an additional cost ranging from several tens of thousands to hundreds of thousands of dollars.

Nomura: Would it be still possible to have it ready in time for the May 1 celebration in the next year?

Hiro: We will give it a try, but it will require the concentrated use of our human resources on the project plus a maximum level of cooperation on your part like giving us needed data and assistance for testing, among others.

Nomura: I see. Well, if you are willing to comply with our request, we will be happy to purchase your Blue Tester as a token of our gratitude. Initially, our budget for the Abshore project

was limited and we were not in a position to pour a large amount of money into it, because we were having another project requiring investment. But that project didn't cost as much as we originally projected, so now we are ready to purchase your cutting-edge Blue Tester. I believe it is priced at US$1 million.

Orange: I was told that the underkill rate of 0.5% is attainable too.

Ohta: Yes. You are right. A cutting-edge, high-performance model. It is capable of identifying defective goods at an accuracy rate far superior to our competitors' models. Ours may cost a bit more but you are sure to gain more than that in the long term. Your purchase is more than welcome; it will boost our sales record.

Nomura: Well, then, let us purchase it. The underkill rate of 0.5% is extremely attractive. We will buy it to partially make up for the extra efforts you will have to put in to accommodate our request for the IFRS.

Orange: Can we still meet the deadline?

Hiro: To be honest, we will be put in an extremely difficult position, but as long as you cooperate with us, I believe we'll be probably able to meet the deadline, somehow, provided that there is no further change or trouble.

Nomura: Thank you for your support.

Hiro: Then, we'll mail our contract later, to Mr. Orange.

A few days later, Hiro sent a standard contract to Orange. Orange signed it and returned it to Hiro. This contract is shown in Exhibit 7 (Please note that any part of the contract not given in Exhibit 7 has no relevance to the problem).

25. During the dinner, another business topic came up. This concerned the development of industrial lithium-ion batteries.

Ohta: By the way, there is another business opportunity I want to discuss with you. As you may have heard, Blue is also very active in the field of industrial lithium-ion batteries. Recently, a leading auto manufacturer in Arbitria has asked us to develop lithium-ion batteries for their electric vehicles. We have concluded, after reviews, that we need your technology for the development of batteries that meet this manufacturer's needs. That is why I brought Smith here, the person HiroSmith who heads our Battery Business Division.

Nomura: I am aware that Blue has been very active in the lithium-ion battery sphere. We too are putting a great deal of resources into the separators used in lithium-ion batteries and have built up a high level of technological expertise. I believe needs for high-performance batteries will continue to grow with greater applications for automobiles, mobile IT devices and so on. Well, Orange here happens to be in charge of materials for separators too.

Ohta: Oh, in that case, I hope you'll consider our proposal. Details should be arranged between Orange and Smith, if it is all right with you.

Nomura: That's fine with me.

26. On July 15, 2010, Smith met with Orange.

Smith: The deal we were talking about the other day came from Brown Corp., a leading manufacturer of cars in Arbitria. Brown is very focused on developing low-priced electric vehicles, and we were contacted for the development of their batteries. Brown and we have been working together for batteries for electric vehicles for some time. But for these particular types of batteries, for which Brown came to us recently, we realized that we are not capable of developing one that satisfies the performance requirements of Brown, if we rely only on our own technology and the current pool of materials suppliers. Our research institute has concluded that we could come up with the battery that meets Brown's needs, if you let us use your separators.

Orange: I see. All right. We'll be glad to work with you. Before signing a formal deal, I would like to visit Brown together with you to discuss this project with them, if it is all right.

Smith: Sure. I think it would be easier for you to study this proposal after you directly discuss it with Brown.

27. After the exchanges described above, a meeting was held among Red, Blue and Brown on July 20, 2010.

Smith: For this battery development project, Red Corp. is willing to work with us. Red's separators are known for having the world's highest quality. I am confident that we'll be able to come up with batteries that satisfy your needs.

Brown: That would be wonderful. An intense race is going on for the development of electric vehicles, and we desperately need high performing but inexpensive batteries.

Orange: We are active in the field of separators, and we take pride in the quality of our separators as the finest in the world. We want to develop great batteries by working together with Blue.

Brown: Would it be possible for you to deliver prototypes of the batteries by the end of February 2011 at the latest, to meet our development schedule for the main body of the vehicle, which is already pretty tight? We will make an official decision on whether to use your batteries after we check their performance.

Orange: Would it be possible for you to give us more time?

Brown: Because of our development schedule, we need prototypes by February. You will have time to improve your batteries after you give us prototypes.

Smith: I see.

Brown: Is it OK to have Blue Corp. serve as our liaison for the purpose of the development agreement for batteries, for the sake of formality?

Orange: That is fine with me.

After the above exchanges, an agreement, which is provided as Exhibit 8, was signed between Brown and Blue on August 1, 2010 (Please note that any part of the agreement not given in Exhibit 8

has no relevance to the problem). The draft of the agreement in Exhibit 8 was sent to Red Corp. prior to signing. The agreement stipulated that in the event of the failure to deliver prototypes meeting the stated quality by February 28, 2011, Brown could terminate the contract, Blue would pay US$100,000 in damage compensation to Brown thereupon and Brown would not be held liable for the cost incurred by Blue for the development of the prototypes. When the draft of Exhibit 8 was sent to Red, the following exchanges took place between Red and Blue regarding the damage compensation provision, which could be enforced in the event of the termination of the agreement

Orange: Can't you have the US$100,000 damage compensation provision deleted from the agreement? My gut feeling tells me there is something discomforting in it.

Smith: Well, I have contacted Brown on this, but they told me this section could not be changed because it is part of their standard contract.

Orange: You mean nothing can be done about it.

Smith: Right.

28. In connection with the agreement shown in Exhibit 8, Red and Blue signed an agreement on August 10, 2010 concerning the joint development of lithium-ion batteries, which appears as Exhibit 9 (Please note that any part of the agreement not given in Exhibit 9 has no relevance to the problem). This agreement was signed by Orange and Smith. Red and Blue embarked on the development of batteries that would meet the needs of Brown. At Red, the director of its Materials Division, Simone (DHF comment: Aha, a female-gender name.), became the person tasked with the project.

29. In the meantime, Hiro visited Red Corp. on September 30, 2010, and Blue delivered its detailed design plan to Red.

Hiro: The detailed design plan is completed. We are ready to move on to programming.

Orange: Thank you very much. We are about one month behind schedule, compared with our original plan. Do you think we can still meet the deadline of May 1 of the next year?

Hiro: Well, the original schedule has a built-in margin of time of about two weeks for testing. If we put more manpower into the programming phase to accelerate it, we will probably manage.

Orange: We have started accepting orders from customers based on the assumption that the factory will be operational on May 1, 2011. If the operational start is pushed back, our customers can hold us liable for damages. I need to ask you for your cooperation.

After the above exchanges, Blue Corp. embarked on the programming work.

30. Red and Blue worked together for the development of lithium-ion batteries. They came up with different prototypes made from materials produced by Red and several others and ran experiments on them, but they could not produce a prototype that would satisfy the needs of Brown. In October 2010, the following discussion was held between Red and Blue concerning the materials used in lithium-ion batteries.

Smith: Until now, we relied on the electrolyte produced by White Corp. What is your opinion?

Simone: It hasn't given us the desired results. I feel it's very difficult to develop batteries that satisfy Brown's needs, if we stick to White's electrolyte, with its quality level.

Smith: I agree with you. But the question is: Is there any other manufacturer that is good enough for Brown? For electrodes, the materials supplied by our current pool of business partners are good enough, but for electrolyte, I can't think of a manufacturer other than White.

Simone: Why don't we try the electrolyte by Black Corp. of Negoland this time? Black is not a large company, but is known for good product craftsmanship.

Smith: Has Red ever worked with Black before?

Simone: Yes. We worked with Black for another battery project for a client. The quality of Black's electrolyte completely fulfilled our expectations.

Smith: Then, we'll stick to our regular suppliers' electrode materials, and we at Blue will take the responsibility of procuring them. But for the electrolyte portion, can I leave it to your organization?

Simone: All right. We at Red will contact Black Corp., then.

31. Simone contacted Black Corp., which gladly complied with her request for the supply of electrolyte. An experiment was conducted using the electrolyte sample given by Black. The battery using Black's electrolyte was good enough to satisfy the needs of Brown. Therefore, Red signed a contract with Black, which is given in Exhibit 10 (Please note that any part of the contract not given in Exhibit 10 has no relevance to the problem), and requested that Black supply the electrolyte needed for the production of lithium-ion batteries.

32. From December 2010 to January 2011, Red and Blue were still working to complete the prototype lithium-ion batteries to be shipped to Blue. In this period, a problem broke out concerning the quality of the electrolyte supplied by Black. It was discovered that the new supply of electrolyte by Black was inferior to the initial sample in terms of purity and general quality. The inferior quality made it impossible for Red and Blue to achieve the performance requirements demanded by Brown. Red requested Black on a repeated basis to improve the quality of the supplied electrolyte. But the quality of the electrolyte never improved despite Black's promise of "trying our best at improving it." A little while later, on January 10, 2011 Black suddenly declared bankruptcy. The course of events leading to Black's bankruptcy, although never revealed externally, included some internal conflict that had a demoralizing effect on employees and led to the resignation of several outstanding technical personnel, compounded by damage compensation demanded pursuant to a large contract for massive defective products delivered by Black.

33. As a result of Black's bankruptcy, Red and Blue met with each other to discuss their response.

Smith: You agreed to be responsible for the electrolyte portion, so it is your responsibility to find an alternative supplier. You need to act quickly; otherwise the project with Brown will

be a disaster.

Simone: We at Red only made reference to Black, and we never said we would take responsibility for the electrolyte portion. We are only responsible for the separator. You agreed to use Black's electrolyte after using their sample and consented to its use.

Smith: No. You are the party to the agreement with Black. So you are responsible for the matters concerning Black.

Simone: We can't solve anything by argument. We need to set aside the issue of who is responsible and decide what to do about the replacement electrolyte supplier.

Smith: I see your point.

In a rush, the two companies searched for a replacement supplier of electrolyte.

34. On January 15, 2011, a meeting was held to consult with each other about electrolyte suppliers.

Smith: The only company we were able to come up with was White Corp. But it is difficult to satisfy the needs of Brown if we use the electrolyte by White.

Simone: There is a company capable of supplying electrolyte that matches the quality of Black. That is Gold Corp. in Negoland. I believe that, in terms of quality, Gold's electrolyte leaves nothing to be desired. But there are some drawbacks. First, their price is high. Given the same level of quality, more or less, Gold's product costs 50% more than Black's. I didn't mention this company initially because of their price. It seems that their price is going up further after Black's bankruptcy. Second, Gold cannot have the capacity to supply at this moment. In fact, I contacted Gold secretly to see how much electrolyte they could give us, and I was told that new orders could not be shipped until about the middle of March, because they already had a large order to fill plus more orders were pouring in after Black's bankruptcy.

Smith: Do you think they can give us a small amount -- just enough to prepare prototypes?

Simone: I asked but was refused.

Smith: Well given the current situation, we have no other choice. Use White's electrolyte and pray for the best.

Simone: Right.

35. Red and Blue used White's electrolyte and made every effort to produce batteries of highest standards, but their attempts fell short of coming up with prototypes that would satisfy the quality requirements of Brown. On March 1, 2011, Brown terminated the agreement it had concluded with Blue pursuant to the provisions of the agreement on the ground that Blue failed to attain the quality standards demanded for the prototypes. Blue explained to Brown that Blue would be able to produce batteries satisfactory to Brown using Gold's electrolyte, if Brown could wait until April, but Brown did not accept this explanation. Blue paid US$100,000 to Brown as damages under Article 10 of the agreement as shown in Exhibit 8. Immediately after terminating the contract with Blue, Brown signed a contract with a Japanese company concerning the development of lithium-ion batteries. If Red and Blue had been able to deliver prototypes satisfactory to Brown, the prototypes

would have led to Brown's decision to use their batteries and subsequent orders from Brown, which in turn would have been translated into profits of US$1 million each to be realized by Red and Blue. This point is not disputed by either party. The cost of developing the batteries for this project, US$100,000 each by Red and Blue, was wasted. This point is not disputed either.

36. Regarding the termination of this agreement, the following exchange took place between Red and Blue.

Smith: Your organization is liable for the termination by Brown. The batteries satisfactory to Brown would have been produced, if Black had supplied us electrolyte with quality as good as the sample's.

Simone: I think you are right to assume that the batteries satisfactory to Brown would have been produced if Black had supplied us electrolyte of the same quality as their sample. But as I told you before, we at Red only introduced Black Corp., and we are not responsible for Black's delivery of inferior products in breach of our agreement or for its bankruptcy.

Smith: Your organization is the one that signed the agreement with Black. So your organization is responsible.

Simone: No, we are not.

Smith: I overheard by accident that you had a stock of Black's high-quality electrolyte. Is that true?

Simone: Yes. But the stock was earmarked for another client. I couldn't use it for the Brown project.

Smith: You couldn't even spare a small portion of it for our purpose?

Simone: No, we couldn't. The stock was barely enough for us to fulfill our contractual obligation to another client. Not enough to spare for the Brown project.

Smith: How come you never mentioned this to us?

Simone: I didn't mention it, because we weren't in a position to make it available for the Brown project, anyway.

Smith: Did you really use the electrolyte for that client?

Simone: No. That customer notified cancellation of the contract. As the consequence, the electrolyte was not used. It is still in our warehouse.

Smith: Really? If so, you should have informed us of the cancellation and, with that electrolyte, we could have performed our duty by the end of February.

Simone: But, if the contract was cancelled, we would have suffered a loss amounting to US$50,000, so we tried to persuade the customer not to cancel the contract. The customer was not firm whether to revoke the cancelation or not. But finally the customer decided to cancel the contract on March 2.

Smith: You shouldn't have tried to persuade the customer, but should have agreed to the cancellation immediately and used the electrolyte for our project. You had an obligation to make that stock available to us. I think your legal liability is very serious.

Simone: No, we had no such obligation.

The discussions between Simone and Smith regarding this issue led nowhere. It is not disputed by either party that Red and Blue would have been able to deliver prototypes satisfactory to Brown by February 28, if the Black's high-quality electrolyte had been available by February 15.

37. The programming work by Blue for the Abshore factory project was completed on April 10, 2011. Prior to the testing of the system, Red had provided Blue with a variety of samples of data, the kinds that Red would use in connection with the production management system. However, a problem was discovered when Blue attempted to enter actual data concerning customer orders to the system. They discovered that data formats different from the data samples previously provided by Red were mixed in, albeit sporadically. The sporadic inclusion of unknown data formats made Blue unable to enter some data into the system, and Blue was forced to correct the portion of the system that deals with customer order processing.

Hiro: We have run into serious trouble. Some customer data formats deviate very much from what we were initially provided with, and the system cannot accept such customer order data.

Orange: What do you mean? But we did give you data samples, didn't we?

Hiro: We certainly received your data samples, but about 30% of the data we received from you for testing purposes were formatted differently than the data we were previously given as samples for the purpose of developing this system. If the system goes uncorrected, after the system goes live I am afraid you will experience frequent errors when you try to enter data concerning customer orders to the system.

Orange: That would be awful. Please correct it.

Hiro: We have begun working on it already. But it will take at least two weeks to complete the correction. Plus, we need to run the test again after the correction. I hate to say this, but the system will not be ready for operation on May 1.

Orange: That will throw everything in jeopardy. Please do something about it.

Hiro: Our initial schedule did include a margin of extra time, but we more than ran out of that as a result of your late response to our request for cooperation in February 2010, the corrective work on the basic design plan caused by Purple's error, and modification work to comply with IFRS requirements, etc. etc. Even if we try our best, the system launch must be pushed back to the end of May. I should also mention that due to the repeated corrective works we were forced to perform, the man-hours have increased from the initially planned 100,000 to 120,000 already. An additional cost of significant size is unavoidable.

Orange: If data samples were that important, why didn't you give me full explanation, when you asked for such data?

Hiro: We gave you a full explanation and when we sent the design plans based on such sample data, we did make a notice on the plans. Nevertheless, the data you gave us was different from the actual ones. Regrettably, you need to shoulder the responsibility for this.

Orange: I never heard that sort of explanation.

Hiro: I am sure the explanation was given when Tolly asked Ross for data.

38. The programming was completed on May 15, 2011. The ceremony was held on May 1, as originally scheduled, but the system, which had to go through testing, did not go live until June 15, 2011. The 1.5-month delay forced Red to turn down many customer orders and caused loss of profits amounting to US$900,000 (loss of US$20,000 per delayed day). Neither party disputes this figure. Exchanges that took place between Tolly and Ross were checked upon Orange's and Hiro's instructions. E-mails (provided as Exhibit 10) were indeed exchanged between the two.

39. After the system went live, it was discovered that the underkill rate for defective goods remained at the vicinity of 1.0%. Orange communicated his dissatisfaction to Hiro.

Orange: Blue Tester only gives us an underkill rate of 1.0%. We thought it would yield a better rate. Given the current rate, we shouldn't have invested in Blue Tester in the first place.

Hiro: We checked the cause of underperformance, and we discovered that it was attributable to the dust and humidity inside the factory. We were unable to verify this during testing, because the environment of the factory, such as for dust and humidity levels, differed when the factory was not in service compared with the factory in service.

Orange: But Blue promised us that Blue Tester would make us achieve the underkill rate of 0.3% to 0.5%. The difference between 0.5% and 1% for the underkill rate is simply not able to be overlooked.

Hiro: The deviation of around 0.5% is within acceptable levels. The stated underkill rate in your contract with Purple was 1%, wasn't it?

Orange: But the president of your organization promised our president that the underkill rate of 0.5% would be achieved.

The underkill rate improved to 0.5% in late July 2011, after Blue, with the help of Red and Yellow, made some adjustment. But Red suffered loss of US$100,000 resulting from the fact the underkill rate remained at around 1% for one and a half months. (There is no dispute over the assumption that the US$100,000 loss would have been avoided, had the underkill rate been 0.5%.)

40. Blue billed Red US$7 million for the cost of developing the system.

Orange: The agreement states that the price is US$5 million.

Hiro: We needed more man-hours. First, an additional 10,000 man-hours for the correction of the basic plan caused by the mistake committed by Purple. Then, we needed to perform modifications to make the system comply with the IFRS, which required an additional 10,000 man-hours. The correction related to customer order data required an extra 20,000 man-hours. The total man-hours amounted to 140,000. The initial price of US$5 million was based on the estimate that man-hours of 100,000 would be required, and this estimate was based on the assumption that no change would be incurred. For additional work we performed at the request of your organization, we have to pass the

cost on to you.

Orange: The contract with you calls for the development of a system within the set budget of US$5 million, and no further agreement has been reached to change that.

Hiro: That is not true. The contract requires us to perform system development in line with the request made by Red, and it does not ask us to undertake the completion of a system within the set budget. Besides, for any system development of this type, the party ordering the system is under obligation to extend cooperation for the development of the system. I believe the agreement explicitly stipulates this point. To my regret, the additional cost and delayed work were attributable to none other than your delay in responding to our requests, the insufficient data you submitted to us, and other violations committed by you with respect to this obligation of cooperation.

41. Red and Blue could not narrow their difference of opinions regarding the system development for the Abshore factory or for the lithium-ion batteries.

For the Abshore factory project, Red demanded Blue pay a total of US$1 million in damage compensation, which was broken down into US$900,000 for the delayed operational launch caused by the system development, and US$100,000 for the underkill rate that remained at 1%. In response, Blue argued that the delayed system development was attributable to Red and that no promise existed to the effect that the underkill rate of 0.5% would be attained. Blue demanded Red to pay a total of US$7 million for the balance of the cost of developing the system (US$6 million) and the cost for Blue Tester (US$1 million).

42. As for the lithium-ion battery project, Blue sought from Red US$100,000 in damage compensation for the cost incurred during development, US$1 million to compensate for the profit Blue would have made if the development had been successful, and US$100,000 for the damages it paid to Brown. Blue also argues, US$100,000 for the damages should be shared by Red and Blue so that Red is obliged to pay US$50,000 to Blue, even if Red is not liable to the matter of the electrolyte. Red, on the other hand, argued that Red was not responsible for the failure of the contract concluded between Blue and Brown and hence the cost of development incurred by Blue and the loss of the profit that would have been made by Blue if the development has been successful should be borne by Blue itself. Red also argued that the US$100,000 in damage compensation paid to Brown should be shouldered by Blue, which was the party to the contract with Brown after all.

**<Round A>**

43. The parties tried to resolve the disputes concerning the Abshore factory and the lithium-ion batteries through negotiations, but the attempts ended in failure. It was agreed that the disputes concerning the Abshore factory and the disputes concerning the lithium-ion batteries would be brought to arbitration with Red as claimant and Blue as respondent for the former, and with Blue as claimant and Red as respondent for the latter.
The arbitrator said he would hear both parties' claims, in particular with regard to the following points, on the scheduled date of December 3 and instructed the parties to prepare for the hearing and to submit a written brief summarizing their respective claims by the designated deadline (In preparing the brief, necessary consideration must be made regarding each party's claims and assertions appearing in this Problem, regardless of who must bear the burden of proof with respect thereto).

Dispute 1: Abshore Factory

Issue 1: Is Blue under obligation to pay a total of US$1 million in damage compensation, which was broken down into US$900,000 for the delayed operational launch caused by the system development, and US$100,000 for the underkill rate that remained at 1%?

Issue 2: Is Red under obligation to pay US$7 million?

Dispute 2: Lithium-ion Batteries

Issue 1: Is Red under obligation to pay US$100,000 to Blue for the cost incurred by Blue for development, and US$1 million for the profit Blue would have made if the development had been successful?

Issue 2: Is Red under obligation to pay Blue for the US$100,000 or US$50,000 for the amount Blue paid to Brown to compensate the damage suffered by Brown?

44. It was announced that in principle hearings for arbitration would take place in the following order. However, modifications may be made if the arbitrator and the parties concerned so arrange on the said day.

13:00 - 13:10: Preparation
13:10 - 13:15: Opening statement regarding Issue 1 by Red
13:15 - 13:20: Opening statement regarding Issue 1 by Blue
13:20 - 14:40: Hearing regarding Issue 1
14:40 - 15:00: Recess
15:00 - 15:05: Opening statement regarding Issue 2 (Blue's counterclaim) by Blue
15:05 - 15:10: Opening statement regarding Issue 2 by Red
15:10 - 16:30: Hearing on Issue 2
16:30 - 16:40: Closing arguments by Red and Blue
16:40 - 17:00: Comments by the arbitrators

**<Round B>**

45. The cases under Round A concerning the Abshore factory and the lithium-ion batteries were brought to arbitration proceedings, but in the course of the proceedings, the two parties realized that it would be very difficult to predict which side would win because of the difficulties of the cases and that arbitration would be very costly. Hence, in the hope for a compromise, the parties decided they would be better off resuming their dialogue and attempt to seek new business opportunities together rather than extending their bickering. In the end, the two parties settled the disputes by splitting the burdens equally between them for both cases.

46. At Red's Abshore factory, the production management system developed by Blue began to function well. Although there had been a number of issues, Red in the end became satisfied with Blue's system. After the compromise was reached, Nomura and Ohta engaged in a conversation over dinner.

Nomura: In spite of the many problems we experienced in the past, our people are very satisfied with the system now. I am glad that we enlisted your help.

Ohta: I am glad to hear that. I agree we had many difficulties but I hope the storm has cleared the air.

Nomura: I agree.

Ohta: Please consider using our systems at other factory locations of yours.

Nomura: Yes. We'll look into that in a positive light.

Ohta: And I hope there'll be more business opportunities where we can work together.

Nomura: Yes, definitely.

47. However, a new problem broke out concerning the Abshore factory. All of a sudden, the government of Arbitria decided to impose much stricter environmental standards on the Abshore area, where the Red's factory is located, in response to the Abshore residents' growing environmental concerns and escalating calls for stricter environmental standards for factories and others. The factories unable to meet the new standards within one year would be ordered to suspend their operation and be disqualified for the preferential tax treatments. The new environmental standards for Abshore are among the strictest in the world in terms of air, sewage, noise and vibration control. The Abshore factory conformed to all the existing environmental standards of Arbitria, but did not conform to the new standards for Abshore. Red would have to invest at least US$2 million more to make the Abshore factory comply with the new standards.

48. About the new standards described above, Nomura and Ohta made the following comments during the above mentioned dinner.

Nomura: By the way, our Abshore factory is in a very difficult position because of the new environmental regulations for the Abshore area.

Ohta: In fact, I hear many Arbitrian corporations are also having difficulties dealing with these

extremely stringent regulations. I think the government was forced to act, after a few pollution-related cases sharply aroused the residents' interest in environmental issues.

Nomura: I understand the government needed to act, but we are the ones to suffer in the face of a sudden change in the regulatory environment. It's extremely difficult to make the factory comply with the new regulations in just one year. But if we don't comply with the regulations, we'll be forced to shut down and our investment will be wasted. The president of Arbitria was the president of Blue. Is there any way for you to talk to him and arrange for some exceptions or milder standards? Without such remedies, we may have to look into the possibility of investment arbitration.

Ohta: Investment arbitration! I am aware that some foreign corporations are thinking of resorting to that. But that could hurt the feelings of the residents and the government, I guess.

Nomura: We want to avoid it as much as possible, but we are accountable to our shareholders, and we have to think what legal means are available.

49. Some time after the above meeting, another joint business opportunity came up. The Republic of Sandland, a developing nation, was inviting bids for a water treatment project in Sandland, and there was a chance for Red and Blue to win the contract by forming a consortium between themselves. Information on water business in the Republic of Sandland is shown in Exhibit 12.

50. Red and Blue focused strongly on water business independent of each other. Red is a manufacturer of high-performance water treatment membranes used for the removal of salts from seawater and purification of waste-water. Red's cutting-edge water filtration membranes include microporous membranes with pore diameters ranging from 1 nanometer to 0.1 nanometer and highly-resistant membranes whose performance is not affected after being washed in chemicals repeatedly. The quality of Red's water treatment membranes is renowned as the finest in the world. Red is also active in the field of seawater desalination. It has won desalination contracts in numerous other countries.

51. Blue has a broad range of experience in plant construction for diverse sectors both domestically and abroad. It has extensive experience in the field of water processing plants too. It has delivered equipment suitable for water purification plants -- the critical component of the water supply system, and has built up know-how and experience for the various phases of water business from water intake, conveyance, purification, distribution and supply facilities to chemical injection and sterilization equipment, as well as power receiving plants and substations.

52. Until now, Red and Blue studied the possibility of entering the water treatment business in Sandland separately. However, neither of the two had any success in winning a contract in Sandland in the past.

53. In the meantime, news was spreading that the government of Sandland would embark on a seawater desalination project in the State of Sand, which faces the sea. In connection with this project, the national government of Sandland and the State of Sand are soliciting proposals from overseas corporations, with a plan to grant a contract to the company with the best proposal. The project size is in the vicinity of US$1 billion. Upon hearing the news, Red and Blue concluded that they could win the project, if the membrane technology of Red, which is effective for desalination, is combined with Blue's superb water treatment engineering capabilities in the water/sewage and industrial spheres.

54. Red and Blue formed a special committee in preparation for the consortium to be formed for the water treatment project. In the special committee, Red is represented by Orange and the directors of the International Business Division, the Water Treatment and Environmental Business Division and Legal Affairs Division, while Blue is represented by Apple, Senior Executive Director in charge of the Environmental Business System Headquarters and the eldest child of the president of Arbitria, and the directors of the Water Treatment Business Division, International Business Division and Legal Affairs Division.

55. Thus far, the special committee discussed principles of the consortium. The analyses of the current situation of the project based on the reliable information are shown in Exhibit 13. Pending issues of importance to be discussed in the next meeting are shown in Exhibit 14. The next meeting of the special committee is scheduled for December 4. The members of the special committee described above are expected to be present at the Dec. 4 meeting (as well as a few additional participants from each company whose presence is needed). During the Dec. 4 meeting, the committee plans to decide on principles of the consortium by primarily focusing on the issues given in Exhibit 14.

(Exhibit 1)

CHAPTER 10 INVESTMENT

**Article 100**

Each Contracting Party shall accord to investments in its territory of investors of the other Contracting Party fair and equitable treatment and full and constant protection and security.

**Article 101**

Neither Contracting Party shall expropriate or nationalise investments in its territory of investors of the other Contracting Party or take any measure tantamount to expropriation or nationalisation except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) upon payment of prompt, adequate and effective compensation; and (d) in accordance with due process of law.

. . .

**Article 105**

In the event that a dispute arises between a Contracting Party and an investor of the other Contracting Party with respect to an investment of the investor, the investor may submit the dispute for settlement by arbitration under the ICSID convention.

*Note: Both Negoland and Arbitria are parties to the ICSID convention.

It is not disputed that Red's Abshore factory is "investment" under Article 100.

(Exhibit 2)

Business Name: Red Corporation
Head Office: Negonego, Negoland
Incorporation: May 24, 1931
Shareholders' Equity on the Balance Sheets: US$6,128 million
Representative: Nomura
Shares: Listed on the Arbitrian Stock Exchange
Operating Results (consolidated)

| Business Year | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Net Sales | 14,335 | 15,531 | 16,967 | 16,237 | 14,986 |
| Chemicals | 6,220 | 6,893 | 8,792 | 7,526 | 6,604 |
| Housing | 3,897 | 4,098 | 3,862 | 4,056 | 4,045 |
| Pharmaceuticals and Medical | 1,132 | 1,196 | 1,112 | 1,044 | 1,058 |
| Textile | 1,012 | 1,164 | 1,140 | 1,066 | 897 |
| Electronics | 1,427 | 1,296 | 1,132 | 1,120 | 1,028 |
| Construction Materials | 470 | 609 | 557 | 608 | 565 |
| Services and Engineering, etc. | 176 | 272 | 370 | 288 | 268 |
| Net Sales - Domestic | 10,631 | 11,591 | 12,094 | 11,957 | 11,254 |
| Net Sales - Overseas | 3,704 | 3,939 | 4,873 | 4,280 | 3,731 |
| Operating Income | 576 | 349 | 1,276 | 1,278 | 1,087 |
| Ordinary Income | 563 | 325 | 1,204 | 12,605 | 1,041 |
| Income before taxes | 460 | 190 | 1,055 | 1,148 | 944 |
| Net Income (Net of non-controlling interests) | 252 | 47 | 699 | 685 | 596 |
| Capital expenditure | 839 | 1,267 | 829 | 844 | 663 |
| Depreciation and Amortization | 861 | 794 | 739 | 716 | 693 |
| Research and Development | 629 | 608 | 561 | 524 | 514 |

(Exhibit 3)

Business Name: Blue Corporation
Principal Office: Abab, Arbitria
Incorporation: November 24, 1910
Shareholders' Equity on the Balance Sheets: US$14,398 million
Representative: Ohta
Shares: Listed on Arbitria Stock Exchange
Operating Results (consolidated)

| Business Year | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Net Sales | 93,158 | 89,685 | 100,003 | 112,267 | 102,479 |
| Information and Communication Systems | 16,520 | 17,055 | 19,453 | 21,982 | 19,648 |
| Electric Power Systems | 8,132 | 8,821 | 8,623 | 11,210 | 9,485 |
| Infrastructure and Industrial Systems | 11,569 | 12,502 | 13,342 | 14,676 | 13,382 |
| Electronic Equipment and Systems | 10,793 | 9,986 | 9,838 | 8,854 | 7,870 |
| Construction Machinery | 7,513 | 5,836 | 7,246 | 8,695 | 7,608 |
| High-Functional Materials | 14,081 | 12,493 | 15,610 | 17,952 | 17,015 |
| Automotive Systems | 7,379 | 6,388 | 6,817 | 6,681 | 6,681 |
| Components & Devices | 8,098 | 7,548 | 9,782 | 11,249 | 9,841 |
| Digital Media and Consumer Electrics | 9,515 | 9,292 | 11,038 | 11,259 | 11,060 |
| Financial Services | 3,729 | 4,196 | 4,013 | 4,575 | 4,214 |
| Others | 7,674 | 7,636 | 8,308 | 10,927 | 10,091 |
| Net Sales - Domestic | 52,692 | 53,138 | 58,614 | 56,134 | 40,992 |
| Net Sales - Overseas | 40,465 | 36,547 | 41,389 | 56,134 | 61,487 |
| Operating Income | 4,445 | 2,021 | 1,271 | 3,455 | 1,825 |
| Income before taxes | 4,322 | 635 | -2,898 | 3,247 | 2,023 |
| Net Income (Net of non-controlling interests) | 2,388 | -1,069 | -7,873 | -581 | -327 |
| Capital expenditure | 5,568 | 5,463 | 7,884 | 9,690 | 10,485 |
| Depreciation and Amortization | 3,827 | 4,417 | 4,787 | 5,414 | 4,721 |
| Research and Development | 3,951 | 3,724 | 4,165 | 4,281 | 4,125 |

Sales by segment include intra-segment transactions.
*Net loss recorded for the years through 2009 was attributable to a global economic slowdown.

(Exhibit 4)

Confirmation Memorandum

- Project: Production Management System for Red Corp's Abshore Factory

- Developmental Needs:
  Ability to respond promptly and appropriately to customers' orders
  Inventory reductions
  Sophisticated product quality control and traceability for defective goods
  Ease of financial and cost accounting
  Real-time system management via the Web

- Fee: US$5 million (estimate based on the planned man-hours of 100,000)

- Method of Development: Waterfall Model

- Delivery Deadline: May 2011

(Exhibit 5)

Proposal

○ Project: Production Management System for Red Corp's Abshore Factory

○ Developmental Needs:

- Ability to respond promptly and appropriately to customers' orders
- Inventory reductions
- Sophisticated product quality control and traceability for defective goods
- Ease of financial and cost accounting
- Real-time system management via the Web

○ Details of Proposal:

- Speedy data processing by using the Blue Light (Note 1) High-Speed Operating System
- Management system for orders and inventories
- Highly-accurate product quality control by using Blue Tester (Note 2)
- Financial and cost accounting system
- Completely Web-enabled management

○ Fee: US$5 million (estimate based on the planned man-hours of 100,000)

○ Method of Development: Waterfall Model

○ Delivery Deadline: May 2011

(Note 1) Blue Light is a cutting-edge high-speed operating system developed and manufactured by Blue. It boasts a computation speed that is 50% faster than conventional systems.

(Note 2) Blue Tester is automatic defective-goods inspection equipment developed and manufactured by Blue. The underkill rate to be realized is 0.3% to 0.5%.

(Exhibit 6)

System Development Agreement

This System Development Agreement (“Agreement”) is made on January 10, 2010, between Red Corporation (“Red”) and Blue Corporation (“Blue”).

WHEREAS:

- Red wishes to develop and implement a production monitoring system for the factory which Red is going to construct in Abshore, Arbitria.
- Blue has agreed to draft a Statement of Work for acceptance by Red and to proceed with the development of a system in accordance with and subject to the terms of this Agreement.

NOW THIS AGREEMENT WITNESSES as follows:

1. DEFINITIONS

In this Agreement and in any schedules or annexes hereto unless the contrary intention appears:
(a) 'Statement of Work' means the Statement of Work developed pursuant to Clause 3 below, including any variations thereof;
(b) 'Application System' means all the computer programs prepared by Blue and supplied to Red under this Agreement including both source code and object code versions;
(c) 'Computer Hardware and Systems Software' means all the equipment and operating system software provided by Blue to Red pursuant to the Statement of Work;
(d) 'Development’ means the analysis and programming services provided by Blue pursuant to this Agreement and the establishment of tables, codes, reference files and editing rules for Red's reasonable requirements in relation to a Statement of Work;
(e) 'Installation’ means the delivery, setting up and configuring of the Computer Hardware and System Software and Application Software pursuant to the terms hereof in accordance with the Statement of Work accepted by Red;
(f) 'Office Procedures' means all facilities, forms and manual processes specified by Blue as required to use the Computer System;
(g) 'Related Items' means all information and all manuals, documentation, notes, improvements, modifications and alterations prepared by Blue and supplied to Red under this Agreement;
(h) 'Computer System' means all Computer Hardware and Systems Software, Application Software, Office Procedures and Related Items developed pursuant to the Statement of Work;
(i) ‘Materials’ means all Systems Software, Application Software, Office Procedures and Related Items developed pursuant to the Statement of Work.

2. TERM

This Agreement shall take effect from the date hereof and shall continue until terminated in accordance with the terms hereof.

3. STATEMENT OF WORK

3.1 Blue shall create a Statement of Work for the Development and Installation of the Computer System.
3.2 Except in circumstances beyond the control of Blue, or except for variations in the requirements or other instructions given by Red that prevent Blue from completing the Statement of Work within the time allowed herein, it is a condition of this Agreement that the Statement of Work be delivered by Blue to Red by February 28, 2010.
3.3 Upon delivery of the Statement of Work to Red for its approval Red shall within fourteen (14) days thereafter:
(a) approve it;
(b) reject it; in which case the Agreement shall be deemed to be terminated or,
(c) request variations to and/or explanations of any aspect or aspects of the Statement of Work.
3.4 When agreed by the parties, the terms of the Statement of Work shall be and is hereby imported and incorporated as terms of this Agreement.
3.5 The Statement of Work as agreed by the parties shall not be changed except by written agreement signed by the parties.

4. THE PROJECT

4.1 For the consideration herein, Blue shall build the Computer System in accordance with and subject to the terms of this Agreement and the Schedule attached hereto.
4.2 In building the Computer System, Blue shall be responsible for directing its own employees.
4.3 In building the Computer System, Blue agrees that time is of the essence under this Agreement.
4.4 In providing the services to be performed or procured pursuant to this Agreement, Blue warrants that all programming and other services shall be provided in a proper and workmanlike manner and at all times in compliance with the standards and procedures for the like programming and services specified at the time of entering this Agreement .

5. OWNERSHIP

5.1 With effect from the time that the parties mutually agree in writing upon the terms of the Statement of Work pursuant to Clause 3 of this Agreement.
(a) Blue grants Red an irrevocable, nonexclusive, paid up (provided that all payment required under this Agreement have been made) license to use, execute, reproduce, display, perform, distribute copies of, and prepare derivative works based upon, the Materials.

(b) Without prejudice to 5.1 (c) either party is free to use, for any purpose, any idea, concept, know-how or technique, which either party individually or jointly, develops or provides during the term of the Project.
(c) Each party agrees to treat as confidential all information received from the other that is not information, which is already in the public domain, or that is not required by law to be disclosed. Each party agrees to disclose such information only to those of its employees who need to know it for the performance of this Agreement.

6. WARRANTIES

6.1 Blue shall indemnify and hold Red harmless from and against any direct loss, damage, cost, liability or expense incurred by Red to the extent directly and proximately caused by and arising out of any infringement by any of the services performed by Blue for Red upon the patent, copyright, trade secret or other proprietary rights of any third party.
6.2 Blue does not warrant uninterrupted or "error free" operation of a Product or Service that is not due to their negligence.
6.3 Except to the extent prohibited by applicable law, except as expressly set forth herein, Blue makes no warranties, expressed or implied, including warranties of merchantability, or fitness for a particular purpose, in connection with this agreement and the transactions contemplated hereby. In no event shall Blue be liable to Red for any indirect, special or consequential damages or lost profits arising out of or related to this Agreement or the performance or breach hereof, even if Blue has been advised of the possibility thereof.

7. PAYMENTS

Red shall pay Blue the fee set forth in the Schedule for the performance of the services.

8. TERMINATION

8.1 Either party hereto may terminate this Agreement if the other party fails to observe or perform any provision of this Agreement and fails to remedy such breach within thirty (30) days after written notice thereof has been given to the party in breach.
8.2 In the event that this Agreement is terminated then each party shall within seven (7) days of the effective date of termination deliver to the other all documents and other materials (including magnetic tapes, disks or other storage media) containing any confidential information obtained from the other during the term hereof and the receiving party shall certify its obliteration by erasure or other appropriate means.

9. AMENDMENTS

No amendment or modification of this Agreement or any provision of this Agreement shall be effective unless agreed by the parties in writing.

10. GOVERNING LAW

This Agreement shall be governed by and construed in accordance with UNIDROIT Principles for International Commercial Contracts 2010.

11. Arbitration

Any dispute arising out of or under this Agreement shall be settled by arbitration in accordance with UNCITRAL Arbitration Rules, in the edition current at the date of this contract.

12. FORCE MAJEURE

12.1 Notwithstanding any other provision in this Agreement, no default, delay or failure to perform on the part of either party shall be considered a breach of this Agreement if such default, delay or failure to perform is shown to be due entirely to causes beyond the reasonable control of the party charged with such default including, but not limited to causes such as strikes, lock-outs or other labour disputes, riots, civil disturbances, actions or inaction of Governmental authorities or suppliers, epidemics, wars, embargoes, storms, floods, fires, earthquakes, acts of God, of the public enemy, computer downtime that arises out of causes beyond the control of Blue (hereinafter called the 'Force Majeure Event').
12.2 If Blue is prevented from delivering the Computer System due to the Force Majeure Event, it shall notify Red of the fact in writing within ten (10) days after the occurrence of the Force Majeure Event.
12.3 If Blue is prevented from delivering the Computer System due to the Force Majeure Event then Blue shall make a reasonable effort to move or eliminate the circumstances preventing delivery and upon cessation of the cause diligently pursue performance of this Agreement.

13. ENTIRE AGREEMENT

This Agreement supersedes and replaces all agreements arrangements and understandings related to the subject matter hereof, whether reduced to writing or not, that may have preceded this Agreement.

IN WITNESS WHEREOF, Red and Blue have executed this Agreement the day and the year first above written.

| | |
|---|---|
| Red Corporation | Blue Corporation |

Schedule to the Agreement

○ Developmental Details: Production Management System for Red Corp's Abshore Factory

○ Items to be Developed:

- Customer Order Processing
- Inventory Control
- Product Quality Control
- Financial Accounting
- Cost Accounting
- System Management
- Others

○Duration of Development: From January 10, 2010 to April 30, 2011

○ Results of Development:

- Software pertaining to the Production Management System for Red Corp's Abshore Factory (One set)
- System Development Design Plan (One set)
- Operation Manual for the System (One set)
- Operating System by Blue (One set)

○ Fee: US$5 million (Planned man-hours of 100,000)

○Work Schedule

- By February 28, 2010: Delivery of the Statement of Work
- By the end of April: Basic Design
- By the end of August 2010: Detailed Design
- From September 2010 to Mid-March 2011: Programming and Development
- Mid-March 2011 to End of April 2011: Tests
- May 1, 2011: Official Operational Commencement

○Payment Schedule

- January 31, 2010 US$1,000,000.-
- Within one month from the completion of the Test US$4,000,000.-

○Inspection Equipment

Equipment by Mellon Corp. (Blue shall procure it and US$500,000 shall be paid by Red to Blue within one month from the completion of the Test)

(Exhibit 7)
<Excerpt from the Front Page>

June 25, 2010

To Mr. Orange,
Red Corporation

Sales Contract

This is to confirm our Sale to you as Buyer, and your Purchase from us as Seller, of the undermentioned Goods subject to the following terms and conditions (INCLUDING ALL THOSE PRINTED ON THE REVERSE SIDE HEREOF), which are expressly agreed to and form an integral part of this Contract.

GOODS
Blue Tester ("Goods")

DELIVERY
Blue shall deliver the Goods to Abshore Factory of Red Corporation (the "Abshore Factory") and install it as a part of the Production Management System of the Abshore Factory.

PRICE
US$1,000,000.-

PAYMENT
The Buyer shall pay the price when the Buyer pays the price within one month after the test of the production management system of the Abshore Factory is completed.

Please sign to express your agreement and confirmation of the above agreement in the space indicated below.

Sincerely,
Blue Corporation
By Hiro

_____

Agreed and Confirmed

Red Corporation
By:

_____

<Excerpt from the Back page>

1. Warranty

Seller makes no warranty or condition, expressly or impliedly, as to the fitness of the Goods for any particular purpose or the merchantability thereof.

2. Increased Cost

Any new, additional or increased freight rates, surcharges, taxes, custom duties, export or import surcharges or other governmental charges or insurance premium or any other reasonable costs incurred by Seller with respect to the Goods after the conclusion of this Contract, shall be for the account of Buyer and shall be reimbursed to Seller by Buyer within a reasonable time after demand.

…

7. Force Majeure

Neither party shall be liable for failure to perform or delay in performing any obligation hereunder to the extent that such failure or delay is attributable to Force Majeure. The term Force Majeure shall mean such acts, happenings, causes or circumstances as, including, but not limited to, war, civil disturbance, labor difficulties or direction of a governmental authority which are beyond the reasonable control of the party affected.

8. Governing Law

This Agreement shall be construed and governed by UNIDROIT Principles for International Commercial Contracts 2010.

9. Arbitration

Any dispute arising out of or under this Agreement shall be settled by arbitration in accordance with UNCITRAL Arbitration Rules, in the edition current at the date of this contract.

(Exhibit 8)

AGREEMENT

THIS AGREEMENT, made and entered into as of this 1st day of August 1, 2010,
by and between Brown Corporation ("Brown") and Blue Corporation ("Blue").

WITNESSETH:
WHEREAS, Brown is desirous of developing the new electrically-powered car,
WHEREAS, Blue is asked by Brown to develop the battery for the car which is satisfactory to Brown,
WHEREAS, Blue, as a joint work with Red Corporation in Negoland, is willing to develop and supply such battery under the terms and conditions herein contained,

NOW, THEREFORE, in consideration of the mutual promises set forth herein and the mutual covenants herein contained, both parties hereto agree as follows:

1. Development of Battery

(1) Blue shall develop the battery which satisfies the conditions as specified by Brown.

…

4. Prototype

(1) Blue shall deliver the prototype of the battery to Brown by the end of February, 2011 for the inspection by Brown.
(2) Upon the delivery of the prototype, Brown shall inspect if it satisfies the conditions as specified by Brown under this Agreement and notify the result of the inspection to Blue within a reasonable time.

…

7. Termination
(1) Brown may terminate this Agreement if –
    (a) Blue fails to deliver the prototype which satisfies the condition specified by Brown by the end of February 2011;
…
(2) In case Brown terminates this Agreement under Clause 7(1)(a), any cost for development incurred by Blue shall be for the account of Blue and Brown shall not have any obligation to

reimburse any amount to Blue.

…

10. Liquidated Damages

In case this Agreement is terminated by Brown under Article 7(1)(a), Blue shall pay US$100,000 to Brown upon the written request from Brown, as liquidated damages.

…

12. Miscellaneous

(1) This Agreement shall be governed by UNIDROIT Principles of International Commercial Contracts (2010 version).

(2) Neither party shall be liable to fulfill its obligations hereunder, or for delays in performance, due to causes beyond its reasonable control, including, but not limited to, acts of God, acts or omissions of civil or military authority, fires, strikes, floods, epidemics, riots or acts of war.

(3) This Agreement sets forth the entire agreement between the parties hereto with respect to the subject matter hereof and is intended to supersede all prior negotiations, understandings and agreements. No provision of this Agreement may be waived or amended, except by a writing signed by the parties hereto.

(4) This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and together which shall constitute one and the same instrument.

(5) The failure of either party to exercise any right or remedy provided for herein shall not be deemed a waiver of any right or remedy hereunder.

(6) Any dispute, controversy or difference arising out of or in relation to or in connection with this Agreement or for the breach thereof, shall be settled by arbitration pursuant to the UNCITRAL Arbitration Rules. The arbitration award shall be final and binding on both parties.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the date first set forth above.

Red Corporation Blue Corporation

(Exhibit 9)

JOINT DEVELOPMENT AGREEMENT

THIS AGREEMENT made as of the 10th day of August, 2010, by and between Red Corporation, a corporation organized and existing under the laws of Negoland (hereinafter "Red"), and Blue Corporation, a corporation organized and existing under the laws of Arbitria
(hereinafter "Blue")

WHEREAS, Red and Blue wish to co-operate with each other and jointly develop and supply the battery to satisfy the demand of Brown Corporation (“Brown”), an Arbitria corporation, for the use of the new electrically-powered car developed by Brown:
WHEREAS, on August 1, 2010, representing Red and Blue, Blue entered into the agreement with Brown with respect to the supply of the battery to Brown:
WHEREAS, Red and Blue intends to agree on the details of the cooperation of the parties to implement this joint project,

NOW THEREFORE, in consideration of the mutual promises contained herein, the Parties agree as follows:

ARTICLE 1

(1) The Parties shall jointly develop the battery to satisfy the demand of Brown , an Arbitria corporation, for the use of the new electrically-powered car developed by Brown.
(2) The details of the conditions which the battery shall satisfy are as specified in the Agreement between Blue and Brown dated August 1, 2010.
(3) Each Party shall provide required expertise and resources to the other Party for the joint development of battery under this Agreement.
(4) Each party shall cooperate in good faith and use its best effort to successfully attain the purpose of this Agreement.
(5) All costs required for the development of the battery shall be born equally.

…

ARTICLE 7

(1) Each party shall retain sole and exclusive ownership of all of their respective technical information and know how relating to the production of battery and the relevant materials as of the date of this Agreement. Both Red and Blue shall have equal joint right to all new technical information and know how developed in the course of this joint project.

(2) The parties agree to cooperate with each other in preparing and filing patent applications on such inventions at joint expense, If either party does not wish to participate in the filing and/or prosecution or maintenance of any such patent application or patent, then it shall upon request promptly assign its interest therein to the other party, and it shall retain a nonexclusive, royalty-free license with the right to sublicense only its affiliates under any patent issuing from such application.

…

ARTICLE 10

(1) Each party agrees, in the event it receives confidential information from the other party, to take all reasonable actions to protect and hold such information in confidence in order to prevent its disclosure to third parties, to use such confidential information only for those purposes contemplated under this Agreement, and to disclose confidential information only to its employees on a need-to-know basis.

…

ARTICLE 12

Each party to this Agreement shall be responsible for its own losses and expenses resulting from injury to, or death of, any person or loss of, or damage to, property or the environment arising out of performance of this Agreement, except when such loss and expenses are caused by the willful misconduct or gross negligence of the other party.

・・・

ARTICLE 14

This Agreement shall be governed by UNIDROIT Principles of International Commercial Contracts (2010 version).

ARTICLE 15

Any dispute arising out of or under this Agreement shall be settled by arbitration in accordance with UNCITRAL Arbitration Rules, in the edition current at the date of this contract.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the date first set forth above.

Red Corporation Blue Corporation

(Exhibit 10)

AGREEMENT

THIS AGREEMENT, made and entered into as of this 1st day of October 30, 2010, by and between Red Corporation (“Red”) and Black Corporation (“Black”).

WITNESSETH:
WHEREAS, Red is developing the new battery in a joint project with Blue Corporation, an Arbitria corporation:
WHEREAS, Black is asked to supply the electrolyte which is necessary to develop the new battery for the joint project,
WHEREAS, Black is willing to supply such electrolyte under the terms and conditions herein contained to the joint project,

NOW, THEREFORE, in consideration of the mutual promises set forth herein and the mutual covenants herein contained, both parties hereto agree as follows:

1. Definition

(1) “Products” shall mean the electrolyte manufactured by Black as specified in Attachment 1 of this Agreement.

…

2. Development of Battery

(1) During the term of this Agreement, Red agrees to purchase from Black, and Black agrees to supply to Red, at the prices determined in accordance herewith, and subject to the terms and conditions hereinafter set forth, the Products.

…

5. Quality of Products

The quality of all Products delivered by Black shall be in accordance with Attachment 1 of this Agreement and meet any and all applicable laws and regulations promulgated by any federal, state, local or municipal governmental authority or agency, including, but not limited to, public safety, health and environmental standards, to be clearly defined by Red from time to time.

…

11. This Agreement shall be governed by UNIDROIT Principles of International Commercial

Contracts (2010 version).

12. Any dispute arising out of or under this Agreement shall be settled by arbitration in accordance with UNCITRAL Arbitration Rules, in the edition current at the date of this contract.

Red Corporation

Black Corporation

(Exhibit 11)

〇E-mail Communications

March 20, 2010: E-mail from Tolly to Ross

" Please send us your customer order data samples. We need samples to proceed with our design work. Based on your samples, we will design the customer order processing portion of the system. If there are any prescribed formats, please send them to us. If several formats are used for orders, please send such things."

March 22, 2010: E-mail from Ross to Tolly

"Thank you for your e-mail. We are thinking about unifying formats for client order placement. I am attaching the current standard formats. We need more time to complete unifying them, though. We are sending you several format examples. Please feel free to contact us should you have anything to discuss with us."

＊No further records illustrating specific exchanges concerning customer order data have been found.

〇Notice on the basic design plan

This part is designed based on the samples of the order data your corporation gave to us. If there is any other format of the order data, please let us know.

(Exhibit 12)

Republic of Sandland
Population: 1 billion
Area: 2.5 million kilometers
Geography: The territory faces the sea in the south and the east, with large rivers running through it.
Nominal GDP: US$1.3 trillion

(Environment surrounding water business)

- Currently, the nation primarily depends on groundwater and surface water for its water supply. The nation has no policy pertaining to the desalination of seawater yet.
- 70% of the population has access to running water, while the sewage system serves only 28 to 30% of the population.
- The nation has sustained high economic growth (at the annual rate of about 7% to 8%), and the water market is expected to grow in tune with its economic development. With the rise in living standards, the public is increasingly interested in sanitation issues, and the nation's economic development is fueling needs for water in various sectors.
- For the upcoming three years, demand for water is expected to increase by 18% for residential use and 8.5% for industrial use.
- The government too is very eager to develop and enhance the nation's water infrastructure.
- In Sandland, the national government is responsible for policy making while each state is mandated to implement specific policies with respect to infrastructure development concerning water. Water is supplied by public water authorities established by individual state governments.
- Water is priced at a very reasonable level of US$0.10 per cubic meter. However, the price could go up in the future.
- In terms of the legal framework, authority exercisable by the nation, the states and the public water authorities is not always clear.
- Many of the local operators are small firms, while select large corporations, the states and the public water utilities have vast control. Rumor has it that bribery is customary in some states.

(Exhibit 13)

Analyses of the Current Situation of the Seawater Desalination Plant Project for Sandland

A comprehensive analysis of the current situation, based on the information gained by approaching the government of Sandland and the relevant state government, is summarized below.

○ National level

- Sandland is looking forward to the success of the desalination project. As far as the size of the project is concerned, it plans to allocate US$1 billion out of the national budget for the desalination plant project, but the government will not mind reducing or increasing the budget to a limited extent, as needed. The government prefers to have ODA (Official Development Assistance) extended in connection with the project, if possible.
- Facing the sea, Sandland hopes that the project, if successful, will be translated into a radically new water measure allowing the nation to secure a new source of quality water supply. Facilities desired include plants with large water treatment capacities, given massive water demand for both residential and industrial use.
- A large-scale industrial zone is currently under construction in the State of Factoria, an adjoining state of the State of Sand. A significant challenge there is to secure water for industrial use.
- The project in question will primarily center on the construction of desalination plants; however, infrastructure needed for the distribution of desalinated water is also an issue that needs to be addressed.
- In addition to the Red/Blue consortium, two other groups have shown interest in the project and have contacted the government on this. The nation plans to select, in consultation with the State, one proposal that best addresses the needs of the nation.

○ State level

- The State of Sand is a commercial center facing the sea, with the third largest population in Sandland. Its infrastructure for water is not very developed, as demonstrated by only 70% of its population having access to running water.
- The state regards this project as an opportunity to develop and enhance infrastructure for water for residential use. By developing both purification plants and water pipes for distribution in combination with the desalination plants, the state hopes that it will be able to supply drinkable tap water.
- It is important to have facilities that are environmentally friendly.

The degree of importance placed by the Nation and the State on the following factors are expressed in the table below, on a scale of 1 to 5 in absolute values.

| | Size of the facilities | High water quality | Cost | Environment | Water distribution system |
|---|---|---|---|---|---|
| Nation | 5 | 4 | 4 | 3 | 3 |
| State | 3 | 5 | 2 | 5 | 5 |

There are still many uncertainties. Therefore, both Red and Blue need to gather more information from reliable sources before the next meeting.

(Exhibit 14)

Pending Issues for the Next Meeting

1. Scope of Proposal

- The issue of whether the proposal should include the development of infrastructure for the water supply system, in addition to the development of desalination plants, must be decided.

  *Blue, with its expertise in the field of infrastructure for the water supply system, is actively seeking the water infrastructure portion to be included in the proposal, while Red has indicated that the proposal should focus strongly on details of desalination plants, which must stand out and impress Sandland to the point that it awards the contract to the Red/Blue consortium.

2. Details of the desalination plants to be proposed

- The key that must be addressed here is to strike a balance between the water quality and the size.
- For desalination plants, three types of membrane: $\alpha$, $\beta$, and $\gamma$, are available among Red's products. If the latest, high-quality membrane $\alpha$ is selected, drinkable water of high quality will be obtained, but it is a costly proposition, if used in large plants. Environmental impact of the wastewater to be discharged from the plants will be minimal in any case, but a slight variation will result depending on chemicals used in the desalination process. Anticipated results to be obtained by each membrane type are given below. It is possible to produce drinkable water, even if $\gamma$ is used, provided that high-performance water purification plants are also built. $\alpha$ is priced at 20% higher and $\gamma$ is priced at 20% lower than $\beta$ for any given processed water quantity.

| | Quality | Environmental Impact | Price (Based on the price of $\beta$ = 1) |
|---|---|---|---|
| $\alpha$ | Can be used as high-quality, drinking water | Almost nil | Expensive (1.2) |
| $\beta$ | Can be used as drinking water | Modest | Median (1) |
| $\gamma$ | Primarily for industrial use | Modest | Inexpensive (0.9) |

3. Price to be quoted

- The vital issue here is whether governmental aid in the form of ODA is obtainable for the project.

- Red and Blue concluded, after consultation with each other, that based on the ordinary construction method, the cost required for Red's desalination plants will be 40% of the total (i.e. based on the assumption that the total project cost will be US$1 billion, US$400 million will go to Red), the cost required for Blue's system will be 30% of the total (i.e. based on the assumption that the total project cost will be US$1 billion, US$300 million will go to Blue), and the cost required for construction work, etc. will be 30% of the total (i.e. based on the assumption that the total project cost will be US1 billion, US$300 million will go to the party undertaking construction).
- Red and Blue have not decided on how to balance the size, water quality and price aspects. The size variations under review are: largest, large, and medium. For the construction of desalination plants with Membrane $\beta$, it will require US$500 million, US$400 million and US$300 million, for the largest, large and medium plant sizes, respectively.

4. Style of project implementation after winning the contract

- A joint venture will be set up to serve as the primary driver for the implementation of the project. Regarding the respective stakes to be held in the venture, Red desires 50-50, while Blue desires 60(Blue)-40(Red) to reflect Blue's additional role as the coordinator for the entire project including the water supply system.
- If the project is awarded, a few additional members (construction company, etc.) must be included in the consortium, with Red and Blue playing the central role. For plant construction, Nego Plant Corp. of Negoland and Ab Plant Corp. of Arbitria are the current candidates.

5. Working together with the governments

If the scope of the project is to include the development of the water supply system, assistance from Nego or Arbitrian public water utilities will also be needed.

*Discussion on any other issues which are beneficial to both parties is not precluded.